88-850

No.

Supreme Court, U.S.
FILED
NOV 22 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

BLINDER, ROBINSON & CO., INC., AND MEYER BLINDER,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

ARTHUR F. MATHEWS *
ANDREW B. WEISSMAN
W. HARDY CALLCOTT
LEE T. LAURIDSEN
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000
Counsel for Petitioners

Of Counsel:
ALAN C. JACOBSON, P.C.
P.O. Box 3115
Englewood, Colorado 80115

November 22, 1988

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Does the restrictive language of *United States v. Swift & Co.*, 286 U.S. 106 (1932), apply literally to requests to vacate injunctions because of changed circumstances, or do later decisions of this Court call for a more flexible balancing of the equities?

2. Is the restrictive language of *United States v. Swift & Co.* the appropriate standard for deciding a motion to vacate an injunction under the federal securities laws in light of the uniquely severe collateral consequences of such decrees?

3. Does the power of the Securities and Exchange Commission to bring judicial actions to enforce the federal securities laws unconstitutionally interfere with the President's duty to take care that the laws be faithfully executed?

RULE 28.1 LISTING

The parent company of petitioner Blinder, Robinson & Co., Inc. is Blinder International Enterprises, Inc. Blinder, Robinson & Co., Inc. has no subsidiaries that must be listed pursuant to Rule 28.1 of the Rules of this Court.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 28.1 LISTING	ii
TABLE OF AUTHORITIES	v
PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT	1
OPINION BELOW	1
JURISDICTION	1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT	3
REASONS FOR GRANTING THE WRIT	7
I. This Court Should Resolve a Conflict Between the Courts of Appeals over the Standard for Determining When Changed Circumstances Warrant Dissolution or Modification of a Permanent Injunction	7
II. The Court Should Determine Whether the Restrictive Language of *Swift* Is the Appropriate Standard for Dissolution or Modification of Injunctions Under the Federal Securities Laws	11
III. The Court Should Determine Whether the Independent Power of the SEC to Institute Civil Judicial Enforcement Proceedings Violates Article II of the Constitution	16
CONCLUSION	30

TABLE OF CONTENTS—Continued

APPENDIX	Page
COURT OF APPEALS OPINION	1a
DISTRICT COURT ORDER DENYING RECONSIDERATION	11a
DISTRICT COURT ORDER DENYING NEW TRIAL	12a
DISTRICT COURT ORDER DENYING MOTION TO VACATE INJUNCTION	14a
DISTRICT COURT TRANSCRIPT OF PROCEEDINGS, MOTION TO VACATE INJUNCTION	16a
DISTRICT COURT MEMORANDUM OPINION AND ORDER IMPOSING INJUNCTION	24a
AFFIDAVIT OF MEYER BLINDER	52a
LETTERS OF CONG. JOHN DINGELL TO SEC CHAIRMAN JOHN SHAD	92a

TABLE OF AUTHORITIES

Cases: Page

Aaron v. SEC, 446 U.S. 680 (1980) 11, 16
Ameron, Inc. v. United States Army Corps of Engineers, 809 F.2d 979 (3d Cir. 1986), *cert. dismissed*, No. 87-163 (Oct. 19, 1988) 28
Blinder, Robinson & Co., Inc. v. SEC, 837 F.2d 1099 (D.C. Cir.), *cert. denied*, 109 S. Ct. 177 (1988) 5
Blinder, Robinson & Co., Inc. v. Tom, 181 Cal. App.3d 283, 226 Cal. Rptr. 339 (1986), *review denied* (Cal. Sup. Ct., Sept. 28, 1988) 4
In the Matter of Blinder, Robinson & Co., [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,052 (1986) 5
Bowsher v. Synar, 478 U.S. 714 (1986) 26, 27, 28
Buckley v. Valeo, 424 U.S. 1 (1976) 19
CFTC v. Nahas, 738 F.2d 487 (D.C. Cir. 1984) 25
The Confiscation Cases, 74 U.S. (7 Wall.) 454 (1869) 19
Fortin v. Commissioner of Massachusetts Dep't of Public Welfare, 692 F.2d 790 (1st Cir. 1982) 9
FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson, 636 F.2d 1300 (D.C. Cir. 1980) 25
FTC v. Universal-Rundle Corp., 387 U.S. 244 (1967) 25
Hecht Co. v. Bowles, 321 U.S. 321 (1944) 16
Heckler v. Chaney, 470 U.S. 821 (1985) 19
Humble Oil & Refining Co. v. American Oil Co., 405 F.2d 803 (8th Cir.), *cert. denied*, 395 U.S. 905 (1969) 9
Humphrey's Executor v. United States, 295 U.S. 602 (1935) ..... *passim*
Industrial Union Dep't, AFL-CIO v. American Petroleum Inst., 448 U.S. 607 (1980) 17
INS v. Chadha, 462 U.S. 919 (1983) 28
The Jewels of the Princess of Orange, 2 Ops. Atty. Gen'l. 482 (1831) 19
King-Seeley Thermos Co. v. Aladdin Industries, Inc., 418 F.2d 31 (2d Cir. 1969) 10

TABLE OF AUTHORITIES—Continued

Page

Morrison v. Olson, 108 S. Ct. 2597 (1988) ..... *passim*
Myers v. United States, 272 U.S. 52 (1926) 26, 28
Nader v. Saxbe, 497 F.2d 676 (D.C. Cir. 1974) 20
Parsons v. United States, 167 U.S. 324 (1897) 19
Pillsbury Co. v. FTC, 354 F.2d 952 (5th Cir. 1966) 28
RKO General, Inc. v. FCC, 670 F.2d 215 (D.C. 1981), *cert. denied*, 456 U.S. 927 (1982) 14
RKO General, Inc. (KHJ-TV), 2 FCC Rcd. 4807 (A.L.J. Rel. Aug. 4, 1987) 14
SEC v. American Bd. of Trade, 751 F.2d 529 (2d Cir. 1984) 11, 14, 15
SEC v. Blazon Corp., 609 F.2d 960 (9th Cir. 1979) .. 15
SEC v. Blinder, Robinson & Co., Inc., 855 F.2d 677 (10th Cir. 1988) ..... *passim*
SEC v. Blinder, Robinson & Co., Inc., [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,491 (10th Cir. 1983), *cert. denied*, 469 U.S. 1108 (1985) 3
SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90 (2d Cir. 1978) 14
SEC v. Crofters, Inc., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,018 (S.D. Ohio Aug. 23, 1982) 15
SEC v. Jan-Dal Oil & Gas, Inc., 433 F.2d 304 (10th Cir. 1970) 9
SEC v. Warren, 76 F.R.D. 405 (W.D. Pa. 1977), *aff'd*, 583 F.2d 115 (3d Cir. 1978) 10, 11, 15
SEC v. Wheeling-Pittsburgh Steel Co., 648 F.2d 118 (3d Cir. 1981) (en banc) 28
Stewart v. General Motors Corp., 756 F.2d 1285 (7th Cir. 1985) 11
Surgidev Corp. v. Eye Technology Corp., 828 F.2d 452 (8th Cir. 1987) 9
System Federation No. 91, Ry. Employees' Dept. v. Wright, 364 U.S. 642 (1961) 8
Thompson v. Tolmie, 27 U.S. (2 Pet.) 157 (1829) .. 29
Tobin v. Alma Mills, 192 F.2d 133 (4th Cir. 1951), *cert. denied*, 343 U.S. 933 (1952) 11

TABLE OF AUTHORITIES—Continued

Page

United States v. City of Chicago, 663 F.2d 1354 (7th Cir. 1981) 11
United States v. Swift & Co., 286 U.S. 106 (1932) ..*passim*
United States v. United Shoe Machinery Corp., 391 U.S. 244 (1968) .....*passim*
Wiener v. United States, 357 U.S. 349 (1958) 27
Young v. United States ex. rel. Vuitton et Fils S.A., 107 S. Ct. 2124 (1987) 21

Legislative Materials:

1 *Annals of Congress* (1789) 19
103 Cong. Record (1957) 28
Report of the House Committee on Interstate and Foreign Commerce on the Independent Regulatory Agencies Act of 1960, H.R. Rep. No. 2070, 86th Cong., 2d Sess. (1960) 27
SEC and Citicorp: Hearings Before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, 97th Cong., 2d Sess. (1982) 28
S. 2544, 100th Cong., 2d Sess. (1988) (International Securities Enforcement Cooperation Act of 1988) 25
H.R. 5133, 100th Cong., 2d Sess. (1988) (Insider Trading and Securities Fraud Enforcement Act of 1988) 25

Constitutional, Statutory, and Regulatory Provisions:

U.S. Constitution, Article II, Section 1, clause 1 ..... 2, 17
U.S. Constitution, Article II, Section 3 ..... 2, 17
Judiciary Act of 1789, 1 Stat. 73 19
52 Stat. 114, March 21, 1938 24
87 Stat. 592, Nov. 16, 1973 24
88 Stat. 2199, Jan. 4, 1975 24
7 U.S.C. § 13a-1 (1982) 18
12 U.S.C.A. § 1425b(c) (West Supp. 1988) 18
15 U.S.C. § 25 (1982) 24
15 U.S.C.A. § 45 (m) (West Supp. 1988) 24
15 U.S.C.A. § 53 (West Supp. 1988) 24

TABLE OF AUTHORITIES—Continued

	Page
15 U.S.C.A. § 56 (West Supp. 1988)	18, 24
15 U.S.C.A. § 78d (West Supp. 1988)	26
15 U.S.C.A. § 78o (West Supp. 1988)	5
15 U.S.C.A. § 78o (b) (4) (C) (West Supp. 1988)	13
15 U.S.C. § 78s (1982)	5
15 U.S.C. § 78u (1982)	16, 18
15 U.S.C. § 78u (d) (1) (Supp. IV 1987)	2
15 U.S.C. § 78u (d) (2) (Supp. IV 1987)	16
15 U.S.C. § 78u-a (Insider Trading and Securities Fraud Enforcement Act of 1988)	16
15 U.S.C. § 78aa (1982)	1
15 U.S.C. § 78ff (c) (Foreign Corrupt Practices Act Amendments of 1988)	16
15 U.S.C.A. § 80a-9 (a) (2) (West Supp. 1988)	13
15 U.S.C. § 2061 (1982)	18
28 U.S.C. § 1254(1) (1982)	2
28 U.S.C. § 1291 (1982)	2
28 U.S.C.A. § 1331 (West Supp. 1988)	1
28 U.S.C.A. § 1337(a) (West Supp. 1988)	1
29 U.S.C.A. § 663 (West Supp. 1985)	18
42 U.S.C. § 2280 (1982)	18
47 U.S.C.A. § 401 (West Supp. 1988)	18
49 U.S.C.A. § 11702 (1988 rev.)	18
Executive Order 12,291, *codified at* 3 C.F.R. 127 (1982)	25
17 C.F.R. § 200.58 (1987)	25
17 C.F.R. § 201.2(e) (1987)	13
15 Fed. Reg. 3175 (1950)	26

Other Authorities:

Andre, *The Collateral Consequences of SEC Injunctive Relief: Mild Prophylactic or Perpetual Hazard?*, 1981 U. Ill. L. Rev. 625	13
W. Cary, *Politics and the Regulatory Agencies* (1967)	26
Cushman, *The Constitutional Status of the Independent Regulatory Commissions*, 24 Cornell L.Q. 163 (1939)	24

TABLE OF AUTHORITIES—Continued

	Page
The Federalist No. 70 (Beloff ed. 1987)	29
1 M. Farrand, *The Records of the Federal Convention of 1787* (rev. ed. 1966)	19
3 L. Loss, *Securities Regulation* (2d ed. 1961)	27
Mathews, *SEC Civil Injunctive Actions*, 30 Bus. Law. 1303 (1975)	13
Miller, *Independent Agencies*, 1986 Sup. Ct. Rev. 41	23
Reaganite Regret: SEC Chief Is Just a Regulator Guy, Wall St. J., July 8, 1988 at 14	26
SEC Lit. Rel. No. 11150, July 8, 1986 *(Ashland Oil)*	28
SEC Rel. No. 82-19, March 5, 1982 *(Citicorp)*	28
SEC Votes to Sue Ashland, Ex-Aide in Bribery Case, Wall St. J., April 2, 1986 at 14 col. 4	28
Steinberg, *SEC and Other Permanent Injunctions —Standards for Their Imposition, Modification, and Dissolution*, 66 Cornell L. Rev. 27 (1980)	7, 13, 15
C. Thach, *The Creation of the Presidency 1775-1789* (1969 ed.)	19
U.K. Bank in Court Battle, Fin. Times, Aug. 18, 1988 at 1	25
U.S. Securities and Exchange Commission, *1987 Annual Report* (1988)	12, 21
Widmer, *The U.S. Securities Laws—Banking Law of the World?*, 1 J. Comp. Corp. L. & Sec. Reg. 39 (1978)	25
11 C. Wright & A. Miller, *Federal Practice and Procedure* (1973)	9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. ____

BLINDER, ROBINSON & CO., INC., AND MEYER BLINDER,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners Blinder, Robinson & Co., Inc. and Meyer Blinder respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit.

OPINION BELOW

The opinion of the Court of Apeals for the Tenth Circuit is reported at 855 F.2d 677, and is reprinted as Appendix A, pp. 1a-10a, *infra*. The rulings of the United States District Court for the District of Colorado are unreported, and are reprinted as Appendices B, C, and D, pp. 11a-15a, *infra*.

JURISDICTION

The jurisdiction of the United States District Court for the District of Colorado was based on 15 U.S.C. § 78aa, 28 U.S.C. § 1331, and 28 U.S.C. § 1337(a). The ruling of the district court was entered on July 11, 1986, and the district court denied reconsideration of that ruling on July 29, 1986. Petitioners sought review of

those rulings in the United States Court of Appeals for the Tenth Circuit pursuant to 28 U.S.C. § 1291. The court of appeals entered a judgment affirming the rulings of the district court on August 24, 1988. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution, Article II, Section 1, clause 1:

> The executive Power shall be vested in a President of the United States of America. He shall hold his Office during the Term of four Years and, together with the Vice President, chosen for the same Term, be elected, as follows. . . .

United States Constitution, Article II, Section 3:

> He shall from time to time give to the Congress Information of the State of the Union, and recommend to their Consideration such Measures as he shall judge necessary and expedient; he may, on extraordinary Occasions, convene both Houses, or either of them, and in Case of Disagreement between them, with Respect to the Time of Adjournment, he may adjourn them to such Time as he shall think proper; he shall receive Ambassadors and other public Ministers; he shall take Care that the Laws be faithfully executed, and shall Commission all the Officers of the United States.

15 U.S.C. § 78u(d)(1) (Supp. IV 1987):

> Whenever it shall appear to the Commission that any person is engaged or is about to engage in any acts or practices constituting a violation of any provision of this chapter, [or] the rules or regulations thereunder, . . . it may in its discretion bring an action in the proper district court of the United States, . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction shall be granted without bond. The Commission

may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

STATEMENT

Petition Blinder, Robinson & Co., Inc. ("Blinder-Robinson") is a broker-dealer with headquarters near Denver, Colorado. In recent years it has become one of the leading underwriters and broker-dealers specializing in low-priced, speculative new issues, commonly known as "penny stocks." The penny stock market is an important source of capital for many small and start-up companies that would not otherwise have access to the U.S. capital markets. Petitioner Meyer Blinder is the chief executive officer of Blinder-Robinson.

In August 1980, the Securities and Exchange Commission ("SEC") filed a civil enforcement action against petitioners in the United States District Court for the District of Colorado, alleging federal securities law violations in connection with the 1979 underwriting of an initial public offering of common stock and warrants by American Leisure Corporation ("American Leisure"). On June 8, 1982, the district court issued an opinion and order finding violations of certain provisions of the securities laws in connection with the American Leisure offering, and enjoining petitioners from committing future violations of those provisions of law. App. 24a. The judgment was affirmed on appeal. *SEC v. Blinder, Robinson & Co., Inc.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,491 (10th Cir. 1983), *cert. denied*, 469 U.S. 1108 (1985).

Since the injunction, Blinder-Robinson has grown rapidly, and has made major changes in its structure, operations, and personnel to assure securities law compliance.

The firm has become a nationwide broker-dealer with 42 offices in 16 states. By 1986, because of turnover in the course of a fourfold increase in employees and brokers, very few of the persons at the firm in 1980 remained. With the exception of petitioner Meyer Blinder, by 1986 virtually every principal officer of the firm at the time of the American Leisure offering, and at the time the 1982 injunction was issued, was gone. App. 66a-69a, 72a-78a. In their place, the firm took on new executives with unblemished records. The firm recruited as its Vice President for Compliance—a newly created position—a national authority on broker-dealer compliance who had spent 14 years as a key compliance official of the National Association of Securities Dealers ("NASD"), a federal, quasi-governmental broker-dealer self-regulatory organization. App. 74a-75a. The new Compliance Manager was another former enforcement official from the NASD. App. 76a. And the firm made a multi-million dollar investment in state-of-the-art equipment and an extensive training program, all designed to prevent the recurrence of securities law violations. App. 78a-81a. These concerted efforts at rehabilitation succeeded: In the 54 underwritings following the American Leisure offering there have been no charges of misconduct or of any violation of the district court's 1982 decree. App. 86a, 91a.

The 1982 injunction continued, however, to restrict and threaten petitioners' business. Based primarily on the injunction, at least eleven states initiated actions to sanction the firm or prevent it from conducting securities business.[1] The SEC also sought to impose severe and

---

[1] The state of California, for example, imposed stiff sanctions including revocation of the firm's registration (suspended pending a three-year probation period), based almost entirely on this injunction. *See Blinder, Robinson & Co., Inc. v. Tom*, 181 Cal. App. 3d 283, 226 Cal. Rptr. 339 (1986), *review denied* (Cal. Sup. Ct., Sept. 28, 1988).

debilitating administrative disciplinary sanctions based solely on the injunction and the court's underlying findings.[2] The firm was rejected when it attempted to lease needed office equipment, despite its excellent financial condition, because of the SEC disciplinary action based on the injunction. App. 57a-61a. And Meyer Blinder has been rebuffed or hindered several times in efforts to invest in other regulated businesses because of the injunction. Federal bank regulators refused to allow him to become a major investor in a federal banking institution; the British Government refused to grant a license to operate an investment banking business in Great Britain; and the injunction looms as an impediment to approval by the Nevada Gaming Commission of his ownership interest in a casino. App. 59a.

In light of the firm's rehabilitation record and the severe collateral consequences of the injunction, petitioners asked the district court to vacate the injunction in a motion filed May 5, 1986. The motion was accompanied by affidavits and exhibits detailing the firm's rehabilitation efforts since the injunction was first issued, and

---

[2] On June 27, 1984, the SEC commenced an administrative disciplinary proceeding against Blinder-Robinson and Meyer Blinder under Sections 15(b) and 19(h) of the Securities Exchange Act of 1934, 15 U.S.C.A. §§ 78o (West Supp. 1988), 78s (1982). In that proceeding, the SEC suspended the firm's broker-dealer registration for 45 days, imposed an additional two-year underwriting suspension on the firm, and barred Meyer Blinder permanently from association with any broker-dealer. *In the Matter of Blinder, Robinson & Co.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,052 (1986). Petitioners appealed the SEC order to the Court of Appeals for the District of Columbia Circuit. The court of appeals, agreeing with appellants that certain mitigating evidence had been erroneously excluded, and raising questions about the SEC's failure to explain apparent disparities in sanctions between over-the-counter broker-dealer firms and New York Stock Exchange member firms, vacated the SEC's order and remanded for further proceedings. *Blinder, Robinson & Co., Inc. v. SEC*, 837 F.2d 1099 (D.C. Cir.), *cert. denied*, 109 S. Ct. 177 (1988).

the harm flowing from the injunction to the firm, to Mr. Blinder, to the many new employees, brokers, and customers who had joined Blinder-Robinson since that time, to the thousands of public shareholders of Blinder International Enterprises, Inc., and to the many companies underwritten by Blinder-Robinson and *their* shareholders. App. 57a-61a. These submissions were wholly uncontroverted: The SEC presented no evidence of any kind in opposition to the motion.

The district court denied the motion to vacate. App. 14a. The court found that petitioners failed to satisfy the requirements for vacating or modifying an injunction set forth in *United States v. Swift & Co.*, 286 U.S. 106 (1932), because the unrebutted evidence before the court did not prove (i) "extreme an unexpected harm," and (ii) that the need for the injunction had been completely eliminated. App. 18a, 21a. The district court also rejected petitioners' contention that the injunctive proceeding was unconstitutional because the separation of powers doctrine precluded Congress' grant to the SEC of the power to represent the United States in law enforcement actions in federal district court. The court stated only that petitioners separation of powers argument was "without merit." App. 11a.

The court of appeals affirmed. App. 1a-10a. It held that the district court properly relied on *Swift*'s literal language for modification of an injunction instead of the more flexible application of *Swift* in *United States v. United Shoe Machinery Corp.*, 391 U.S. 244 (1968). The court also concluded that Congress' grant of civil law enforcement powers under the federal securities laws to the SEC did not violate the Constitution. App. 10a. Petitioners seek review of both of these rulings.

REASONS FOR GRANTING THE WRIT

I. This Court Should Resolve a Conflict Between the Courts of Appeals over the Standard for Determining When Changed Circumstances Warrant Dissolution or Modification of a Permanent Injunction.

This petition presents the Court with an opportunity to resolve a conflict between the courts of appeals over the appropriate standard for dissolution or modification of an injunction when circumstances have changed. This conflict stems from disagreement over the meaning of this Court's decisions in *United States v. Swift & Co.*, 286 U.S. 106 (1932), and *United States v. United Shoe Machinery Corp.*, 391 U.S. 244 (1968). The law in this area is clearly in disarray. One commentator has identified at least five different standards in the reported decisions.[3] And the underlying issue is a key one: It is important to make it clear when the federal courts should be willing to terminate the continuing oversight inherent in a permanent injunction.

In *Swift*, the Court recognized that "a court of equity [may] modify an injunction in adaptation to changed conditions," since otherwise the injunction might be turned into "an instrument of wrong." 286 U.S. at 114-15. Focusing in that case on the particularly gross abuse of power that led to the earlier issuance of an antitrust consent decree, the Court refused to modify the decree in the absence of changes "so important that dangers, once substantial, have become attenuated to a shadow." *Id.* at 119. The Court also noted defendant's failure to show "extreme and unexpected" hardship caused by "new and unforeseen conditions." *Id.*

In *United Shoe*, the Court placed the language of *Swift* in context. The Court held that the district court "mis-

---

[3] Steinberg, *SEC and Other Permanent Injunctions—Standards for Their Imposition, Modification, and Dissolution*, 66 Cornell L. Rev. 27, 59 (1980).

conceived the thrust of this Court's decision in *Swift*" when it applied the harsh *Swift* standard where the modification sought did not threaten to reintroduce the dangers underlying the original injunction:

> [*Swift*] must, of course, be read in light of this context. *Swift* teaches that a decree may be changed upon an appropriate showing, and it holds that it may *not* be changed in the interests of the defendants if the purposes of the litigation as incorporated in the decree . . . have not been fully achieved.

391 U.S. at 248 (emphasis in original).[4]

Since *United Shoe*, the courts of appeals have divided. Some, including the court below, have held that *Swift*'s demanding language must be satisfied before any injunction can be modified or dissolved. Others recognize that *Swift* used extreme language to deal with an extreme case, but that *Swift* and *United Shoe* together make it clear that a motion to modify or vacate an injunction should be decided by examining the impact of changed circumstances on the equities underlying the injunction. In these circuits, an injunction may be modified if the continuing need for the injunction is outweighed by the unwarranted harm it is causing.

The Tenth Circuit applied "the standards of *Swift*" literally. App. 5a. It disregarded the unrebutted evidence of rehabilitation and of the continuing harsh collateral consequences from the injunction. The court affirmed the denial of petitioners' motion to vacate because they could not (in the court's view) make a clear showing of (1) a "grievous wrong," and (2) harm "evoked by new and unforeseen conditions." App. 4a.

---

[4] *Accord System Federation No. 91, Ry. Employees' Dept. v. Wright*, 364 U.S. 642, 647 (1961) ("a sound judicial discretion may call for the modification of the terms of an injunctive decree if the circumstances, whether of law or fact, obtaining at the time of its issuance have changed or new ones have since arisen").

The court expressly rejected petitioners' contention that this Court's decisions in *Swift* and *United Shoe* called for a more flexible consideration of the equities. App. 4a-5a.[5]

This approach is typical of those circuits—*e.g.*, the First, Eighth, and Tenth—that look exclusively to *Swift*'s harsh language as the test for modification of a decree. *Humble Oil & Refining Co. v. American Oil Co.*, 405 F.2d 803 (8th Cir.), *cert. denied*, 395 U.S. 905 (1969), is the leading example cited by the commentators.[6] In *Humble Oil*, movants sought modification of a thirty-year old injunction limiting their ability to use their trademark "Esso" in fifteen midwestern states. Acknowledging that it was requiring movants "to provide close to an unanswerable case," *id.* at 813, the court held that an injunction may not be modified unless each phrase of the *Swift* test is satisfied. Thus, persons seeking dissolution or modification must be able to demonstrate that the "dangers which the decree was meant to foreclose . . . almost have disappeared," that they are suffering "oppressive hardship," and that the hardships were "unforeseen" by the issuing court. *Id.* (quoting *Swift*, 286 U.S. at 119). A showing that fails to establish even one of the elements results in denial of the application.[7]

---

[5] *Accord SEC v. Jan-Dal Oil & Gas, Inc.*, 433 F.2d 304, 305 (10th Cir. 1970) (requiring a showing of grievous, unforeseen harm and a complete absence of continued need).

[6] *See* 11 C. Wright & A. Miller, *Federal Practice and Procedure* § 2961 (1973).

[7] *See* 11 C. Wright & A. Miller, *Federal Practice and Procedure* § 2961 (1973); *see also Surgidev Corp. v. Eye Technology, Inc.*, 828 F.2d 452, 458 (8th Cir. 1987) (applying *Humble Oil* interpretation of *Swift*); *Fortin v. Commissioner of Massachusetts Dep't of Public Welfare*, 692 F.2d 790 (1st Cir. 1982) (strict application of *Swift's* "grievous wrong" test).

The Second, Third, Fourth, and Seventh Circuits have concluded that *Swift* and *United Shoe* call for a more flexible approach. Rather than requiring a showing of (1) grievous suffering, (2) evoked by unforeseen conditions, and (3) the virtual disappearance of the danger the injunction was designed to prevent, these courts balance the harm being caused by the injunction against the continuing need for it and the judicial interest in stability of judgments.

A leading example is Judge Friendly's opinion in *King-Seeley Thermos Co. v. Aladdin Industries, Inc.*, 418 F.2d 31 (2d Cir. 1969). The Second Circuit vacated a district court's order refusing to modify an injunction, finding that the district court had given "the *Swift* decision a rigidity the Court did not intend." *Id.* at 34. The court also rejected the Eighth Circuit's total reliance on *Swift* "as imposing too severe a requirement as a general rule." *Id.* at 35 n.2. Noting that even the *Swift* Court had acknowledged that an "injunction directed to events to come is subject always to adaptation as events may shape the need," *id.* at 34 (quoting *Swift*, 286 U.S. at 114), the court opted for a flexible application of the court's equitable powers. Not only do "changes in fact or law afford the clearest bases for altering an injunction," but the same remedy can be granted "where a better appreciation of the facts in light of experience indicates that the decree is not properly adapted to accomplishing its purposes." *Id.* at 35.

Likewise, the Third Circuit, noting that *United Shoe* provides "perspective" on the *Swift* standard, approved a flexible test weighing the severity of the danger the injunction was designed to eliminate against the continuing necessity for the injunction and the hardship it is causing.[8] In so doing, it expressly rejected Eighth and

---

[8] *See SEC v. Warren*, 583 F.2d 115, 119-120 (3d Cir. 1978), *aff'g*, 76 F.R.D. 405, 408 (W.D. Pa. 1977).

Tenth Circuit precedent requiring strict adherence to *Swift*'s language.[9]

"An injunction is a drastic remedy, not a mild prophylactic[.]" *Aaron v. SEC*, 446 U.S. 680, 703 (1980) (Burger, C.J., concurring). When the decree is issued, the court becomes the defendant's overseer. And until the decree is lifted, the court maintains continuing power over that person. This is necessary in some cases to assure compliance with the laws. But once the need for oversight has diminished to the point that the harm it causes is greater than the benefit derived from the court's continuing role, the court should be willing to end its involvement.

Where *Swift* is applied literally, the near impossibility of getting an injunction vacated has led to an ever-increasing number of cases in which the courts retain power over the defendants. This is not, petitioners submit, healthy either for the courts or for the persons kept within the judicial power. This Court should resolve the conflict between the circuits, and should do so by making it clear that the federal courts should be receptive to dissolving or modifying injunctions when changed circumstances show that the equities no longer favor them.

II. The Court Should Determine Whether the Restrictive Language of *Swift* Is the Appropriate Standard for Dissolution or Modification of Injunctions Under the Federal Securities Laws.

This Court has never defined the standard that should govern a motion to vacate or modify an SEC injunction. To fill that vacuum, some courts, including the court be-

---

[9] *Id.* at 118-19. *Accord Stewart v. General Motors Corp.*, 756 F.2d 1285, 1291 (7th Cir. 1985); *SEC v. American Bd. of Trade*, 751 F.2d 529, 543 (2d Cir. 1984); *United States v. City of Chicago*, 663 F.2d 1354, 1359-60 (7th Cir. 1981); *Tobin v. Alma Mills*, 192 F.2d 133, 136 (4th Cir. 1951), *cert. denied*, 343 U.S. 933 (1952).

low, apply the restrictive language in *Swift* in the context of SEC injunctions. *Swift*'s language, however, is especially inappropriate for determining whether to dissolve an SEC injunction because it fails to give weight to the unusual and severe collateral consequences that accompany an SEC injunction.

The SEC filed 1,699 injunctive actions against 5,931 defendants between 1976 and 1987.[10] Almost none of these injunctions could ever be (or ever are) terminated under the *Swift* standard. Except for individual defendants who have died in the interim, virtually every defendant enjoined by the SEC since 1934 is still subject to that injunction. As a result, the federal courts exercise continuing jurisdiction over the securities law compliance of literally thousands of individuals and corporations.

The negative consequences that attend an antitrust decree may be direct and necessary to the operation of the decree. *Swift* itself illustrates the point. There, the antitrust consent decree prohibited defendants from engaging in certain non-meat food businesses. Those proscriptions were deemed necessary to prevent defendants from using the economic power gained from a monopoly in one food business to thwart competition and spread their monopoly to all food industries. Defendants sought modifications of the decree to permit them to engage in several of those proscribed businesses on the grounds that the circumstances calling for the injunction had changed and the decree was causing them to suffer lost business opportunities. Those consequences were not only "foreseeable," but were necessary to assure that the decree achieved its purpose. Because the Court concluded that the reasons for imposing the proscription continued "with undimin-

---

[10] U.S. Securities and Exchange Commission, *1987 Annual Report* at 151, Table 37 (1988).

ished force," 286 U.S. at 115, it could not allow such "foreseeable" and necessary harm to serve as the very reason for modifying the decree.

Unlike an antitrust decree, an SEC injunction often has debilitating consequences that go well beyond preventing the violations of law that the court fears might recur. For example, the mere existence of an injunction can be used to suspend or revoke a broker-dealer's license to continue in business; to disqualify a person from associating with a broker-dealer; to disqualify an individual from serving as a director, officer, or employee of a registered investment company; and to disbar a professional from practice before the SEC.[11] These collateral consequences can be pursued not only by the SEC, but by each individual state securities commissioner. At least eleven states have used or are seeking to use the injunction imposed in this case to sanction Blinder-Robinson, often initiating cases years after the injunction was issued. The SEC as well is using the injunction in an attempt to suspend the firm and bar Meyer Blinder from the securities industry.

Even in areas wholly outside of the securities industry, an SEC injunction can carry great weight in the regulatory or licensing process, and in basic business transactions. In one current case, the Federal Communications Commission is considering whether to preclude the renewal of broadcasting licenses to a major communications company in substantial part because of an SEC

---

[11] *See* 15 U.S.C.A. § 78o(b)(4)(C) (West Supp. 1988) (broker-dealer); 15 U.S.C.A. § 80a-9(a)(2) (West Supp. 1988) (investment company); 17 C.F.R. § 201.2(e) (1987) (disbar professionals). *See also* Andre, *The Collateral Consequences of SEC Injunctive Relief: Mild Prophylactic or Perpetual Hazard?*, 1981 U. Ill. L. Rev. 625; Steinberg, *SEC and Other Permanent Injunctions—Standards for Their Imposition, Modification, and Dissolution*, 66 Cornell L. Rev. 27, 37-39 (1980); Mathews, *SEC Civil Injunctive Actions*, 30 Bus. Law. 1303, 1307-10 (1975).

injunction against its parent corporation.[12] And uncontradicted affidavits in the case at bar show that the SEC injunction has prevented or severely limited Meyer Blinder's attempts to invest in federal banking institutions, to operate an investment banking business outside of the United States, and to obtain an ownership interest in a gambling casino. Even Blinder, Robinson's ability to lease needed office equipment has been impaired. App. 59a.

The severity of these adverse collateral consequences has prompted a number of courts in recent years to require the SEC to meet a stricter standard before the court will grant an injunction.[13] These consequences should be at least as relevant to a court's determination whether an existing injunction should be dissolved or modified. Years after an injunction is issued the defendant may learn that a collateral effect of no appreciable concern years earlier has taken on much greater significance. If that person can also show a reduced need for the injunction because of rehabilitation or other changed circumstances, the court should determine whether, all

---

[12] *See RKO General, Inc. v. FCC*, 670 F.2d 215, 219 (D.C. Cir. 1981), *cert. denied*, 456 U.S. 927 (1982). RKO, because of problems arising in part from the SEC injunction imposed against its parent, was stripped of a major market VHF station in Boston and forced to sell at a reduced price a television station in New York. The Administrative Law Judge in that proceeding has recommended that licenses for RKO's 14 other stations worth hundreds of millions of dollars not be renewed. *RKO General, Inc. (KHJ-TV)*, 2 FCC Rcd 4807 (A.L.J. Rel., Aug. 4, 1987).

[13] *See, e.g., SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 99 (2d Cir. 1978) ("It is fair to say that the current judicial attitude toward the issuance of injunctions on the basis of past violations at the SEC's request has become more circumspect than in earlier days. Experience has shown that an injunction, while not always a 'drastic remedy,' . . . often is much more than [a] 'mild prophylactic' "); *SEC v. American Bd. of Trade, Inc.*, 751 F.2d 529, 535-36 (2d Cir. 1984).

things considered, the balance of needs and equities suggests that the injunction be lifted.[14]

The application of the *Swift* standard to SEC injunctions, however, virtually precludes the court from making such determinations. *Swift*, as applied by the court below, "requires clear proof of *unforeseen* conditions[.]" App. 5a (emphasis in original). But because the collateral consequences of an SEC injunction are well known, it is always foreseeable that an enjoined party might be subjected to them. The decision of the court below to sweep aside petitioners' unanswered evidence of rehabilitation and collateral consequences merely because the district court "was cognizant of these consequences when the injunction was issued," *id.*, shows how ill-fitted the *Swift* language is to the SEC injunctive context.

The literal use of the *Swift* test thus almost assures that in some, and perhaps many, instances an SEC injunction will become the "instrument of wrong" the *Swift* Court sought to avoid. *Swift*, 286 U.S. at 114-15. A court should be allowed—indeed, should be compelled—to consider the relative harms and benefits of leaving an SEC injunction in place as part of its consideration of the propriety of continuing equitable relief.

---

[14] Many courts do indeed engage in an explicit balancing approach to determine whether to modify or vacate an SEC injunctive decree. *See, e.g., SEC v. Warren*, 583 F.2d 115 (3d Cir. 1978); *SEC v. Crofters, Inc.*, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,018, at 94,820 (S.D. Ohio Aug. 23, 1982). *See also* Steinberg, *SEC and Other Permanent Injunctions—Standards for Their Imposition, Modification, and Dissolution*, 66 Cornell L. Rev. 27, 71 (1980) (suggesting use of a balancing test when reviewing a motion to dissolve or modify an SEC injunction). *Cf. SEC v. American Bd. of Trade Inc.*, 751 F.2d 529, 543 (2d Cir. 1984) (instructing district court to "give serious consideration" to a motion to dissolve an SEC injunction "if and when [the defendant] has set [his] house in order"); *SEC v. Blazon Corp.*, 609 F.2d 960, 966-68 (9th Cir. 1979) (upholding an SEC injunction that allowed defendants to seek dissolution after 18 months).

This Court has consistently stressed that the purpose of an injunction is "to deter, not to punish," *Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944); *cf. Aaron v. SEC*, 446 U.S. 680, 703 (1980) (Burger, C.J., concurring). But the literal application of *Swift* to SEC injunctions serves only to enhance their punitive collateral consequences even when the need for a deterrent has lost its force. Even if this Court chooses not to address the broader issue of standards governing dissolution of all permanent injunctions, it should decide whether the thousands of persons now enjoined in SEC actions, or who in the future will be subject to an SEC injunction, will be able to have the injunction modified or lifted when they can show that the equities no longer favor leaving it in place.

III. The Court Should Determine Whether the Independent Power of the SEC to Institute Civil Judicial Enforcement Proceedings Violates Article II of the Constitution.

The SEC decides, in its own discretion, whether to institute civil law enforcement proceedings in district court against an alleged violator of the federal securities laws.[15] The Securities Exchange Act of 1934 ("1934 Act") precludes any participation in these decisions by the President. The court of appeals erred when it ruled that Congress' removal of this entire area of law enforcement from the Executive Branch is consistent with the Constitution's allocation of powers among the Branches of Government.

---

[15] This power extends to civil injunctive actions like the instant proceeding, *see* 15 U.S.C. § 78u (1982), and, under recent legislation, to actions to collect civil penalties for certain securities law violations. *See* 15 U.S.C. § 78u(d)(2) (Supp. IV 1987) (Insider Trading Sanctions Act) (treble penalty); 15 U.S.C. § 78ff(c) (Foreign Corrupt Practices Act Amendments of 1988) ($10,000 civil penalty); 15 U.S.C. § 78u-a (Insider Trading and Securities Fraud Enforcement Act of 1988) ($1 million civil penalty).

Article II of the Constitution vests "the executive Power" in the President and imposes on the President the duty to "take Care that the Laws be faithfully executed." Under the interpretation of these provisions adopted by this Court in *Morrison v. Olson*, 108 S. Ct. 2597 (1988), Congress may not grant to a non-Executive agency law enforcement authority over statutes of the breadth and consequence of the Nation's securities laws. The allocation of civil prosecutorial authority to the SEC and other independent agencies undermines the President's ability to execute the laws in a range of areas of central importance to the Federal Government. Petitioners urge this Court to grant a writ of certiorari to clarify the extent to which Congress can so strip the President of his constitutional power and duty to execute the laws.

Petitioners do *not* challenge the constitutionality of the SEC. They do *not* contend that the Constitution mandates that SEC Commissioners be freely removable by the President.[16] And they do *not* question Congress' power to delegate to the SEC quasi-legislative rulemaking authority, or quasi-judicial administrative adjudicatory powers.[17] Petitioners contend only that Article II of the Constitution precludes Congress from giving the SEC a broad range of the President's prosecutorial authority.

Petitioners' challenge to the SEC's independent law enforcement authority does not threaten the SEC's ability to function as an independent administrative agency. Many such agencies function without independent civil prosecutorial authority. They are required by statute to

---

[16] *Compare Humphrey's Executor v. United States*, 295 U.S. 602 (1935) (upholding restriction on President's power to remove members of Federal Trade Commission).

[17] *Compare Industrial Union Dep't, AFL-CIO v. American Petroleum Inst.*, 448 U.S. 607, 672-76 (1980) (Rehnquist, J., concurring) (discussing non-delegation doctrine).

obtain Department of Justice approval before civil enforcement actions can be brought,[18] as is the SEC when it seeks criminal prosecution of any securities law violator.[19] There is no reason to believe that the SEC's enforcement efforts would be significantly impaired by requiring the concurrence of the Department of Justice before the filing of civil injunctive actions.

In contrast, the proliferation of independent agencies with independent prosecutorial authority truly undermines the President's power to enforce the laws. Independent agencies governing an enormously wide range of United States commerce—the SEC, the Federal Trade Commission, the Interstate Commerce Commission, the Consumer Product Safety Commission, the Federal Home Loan Bank Board, and the Commodity Futures Trading Commission—now have independent civil prosecutorial authority.[20] Together, these agencies exercise immense power over the Nation's economy. This Court should review a ruling holding that law enforcement in these and presumably any other areas chosen by Congress can be withdrawn from the President.

The Framers recognized that the power to enforce the laws is fundamentally executive in nature. In the Federal Convention of 1787, "[t]he executive problem was . . . primarily one of law enforcement, the institution of a department well enough equipped with power to see to

---

[18] *See, e.g.*, 47 U.S.C.A. § 401 (West Supp. 1988) (Attorney General to bring actions on behalf of Federal Communications Commission); 42 U.S.C. § 2280 (1982) (Attorney General to bring civil injunctive actions on behalf of Nuclear Regulatory Commission); 29 U.S.C.A. § 663 (West Supp. 1985) (Secretary of Labor to bring civil injunctive actions on behalf of Occupational Safety and Health Administration, subject to direction and control of Attorney General).

[19] *See* 15 U.S.C. § 78u (1982).

[20] *See* 15 U.S.C.A. § 56 (West Supp. 1988) (FTC); 49 U.S.C.A. § 11702 (1988 rev.) (ICC); 15 U.S.C. § 2061 (1982) (CPSC); 12 U.S.C.A. § 1425b(c) (West Supp. 1988) (FHLBB); 7 U.S.C. § 13a-1 (1982) (CFTC).

it that the laws were faithfully executed." [21] Article II therefore gave the President the power and duty to execute the laws.

The Judiciary Act of 1789 implemented this executive law enforcement authority by providing for federal attorneys "whose duty it shall be to prosecute . . . all delinquents for crimes and offences, cognizable under the authority of the United States, and all civil actions in which the United States shall be concerned," and for an Attorney-General "whose duty it shall be to prosecute and conduct all suits in the Supreme Court in which the United States shall be concerned[.]" 1 Stat. 73, 92-93 (1789). This Court has since held that the power to prosecute cases before the federal courts belongs to the President, and therefore that the "courts will not recognize any suit, civil or criminal, as regularly before them, if prosecuted in the name and for the benefit of the United States, unless the same is represented by the district attorney, or some one designated by him[.]" *The Confiscation Cases*, 74 U.S. (7 Wall.) 454, 457 (1869).[22] The Court has repeatedly made it clear that this power extends to civil law enforcement actions.[23]

---

[21] C. Thach, *The Creation of the Presidency 1775-1789*, 77 (1969 ed.); *see* 1 *Annals of Congress* 481 (J. Gales ed. 1789) (James Madison) ("I conceive that if any power whatsoever is in its nature executive, it is the power of appointing, overseeing, and controlling those who execute the laws"); 1 M. Farrand, *The Records of the Federal Convention of 1787* 66 (rev. ed. 1966) (James Wilson) ("The only powers he conceived strictly Executive were those of executing the laws, and appointing officers").

[22] *See also Parsons v. United States*, 167 U.S. 324, 328-34 (1897) (holding that President must have power to control United States Attorneys); *cf. The Jewels of the Princess of Orange*, 2 Ops. Atty. Gen'l. 482 (1831) (Constitution requires that the President control the government's litigation).

[23] *See The Confiscation Cases*, 74 U.S. at 457; *Heckler v. Chaney*, 470 U.S. 821, 831 (1985); *Buckley v. Valeo*, 424 U.S. 1, 138 (1976) ("A lawsuit is the ultimate remedy for a breach of the law, and it

At some point, the piecemeal reduction of presidential control over the nation's law enforcement comes into conflict with these well-settled principles. At some point, the diversion to non-executive officials of law enforcement powers given by the Constitution to the President unbalances the careful division of governmental power conceived by the Framers. Petitioners contend that this Court should decide whether the transfer of law enforcement power to the SEC in the 1934 Act passes that point.

Last Term, in *Morrison v. Olson*, 108 S. Ct. 2597 (1988), this Court set forth the framework for analyzing this issue. In *Morrison*, the Court adopted a functional analysis to test the validity of legislative encroachments on the law enforcement authority of the Executive Branch, holding that such encroachments are unconstitutional only if they "are of such a nature that they impede the President's ability to perform his constitutional duty." *Id.* at 2619. *Morrison* upheld the provisions of the Ethics in Government Act, which provide for the appointment of a counsel independent of Executive Branch control to prosecute certain criminal cases, because the Court found the degree of intrusion into the President's power to execute the laws insufficient to hamper in any significant way the President's ability to perform his Article II duties. *Id.* at 2621-22.

Applying the same test in this case leads to a very different result: The withdrawal from the President of law enforcement authority over key, extensive areas of the Nation's commerce so greatly intrudes on his ability to execute the laws that it grievously undermines his Article II powers. And even if such a significant portion of the executive power could be stripped from the President under a "compelling interests" test—which is by no

---

is to the President . . . that the Constitution entrusts the responsibility to 'take Care that the Laws be faithfully executed' "); *see also Nader v. Saxbe*, 497 F.2d 676, 679-80 & n.19 (D.C. Cir. 1974).

means clear from the discussion in *Morrison*—the SEC scheme, which clearly results more from happenstance than necessity, has no such compelling support.

The present case presents the antithesis of *Morrison* on virtually every significant factor identified by the Court:

- The independent counsel statute withdrew power from the President over an extremely narrow prosecutorial area. Only a limited number of high-level presidential appointees are even potentially subject to investigation by an independent counsel. 108 S. Ct. at 2603. In contrast, there is no limit on whom the SEC may investigate and prosecute within the broad range of its statutory authority.[24] In the past twelve years, the SEC has instituted district court civil enforcement actions against some 5,931 defendants.[25]

- The Attorney General's decision to request an independent counsel for any given allegation of misconduct is within his unreviewable discretion. 108 S.Ct. at 2621. In contrast, no Executive Branch officer has any role at any time in the SEC's decision to prosecute a case.

- Once appointed, an independent counsel is limited to the facts and the potential defendants referred by the Attorney General. *Id.* The SEC has unlimited authority over the scope of its cases.

- An independent counsel's appointment is limited to the resolution of a specific case. *Id.* at 2614-15. But the SEC is a continuing part of the government, and is thus in a position to control the application of the laws over an extended period of time.

---

[24] *See Young v. United States ex rel. Vuitton et Fils S.A.*, 107 S. Ct. 2124, 2134 n.10 (1987) (holding that limited authority of court to prosecute contempt of parties before it provides no principle allowing prosecution of entire population except by Executive Branch).

[25] U.S. Securities and Exchange Commission, *1987 Annual Report*, at 151, Table 37 (1988).

- The independent counsel is commanded, where practicable, to follow Department of Justice guidelines in conducting any investigation and bringing any case. *Id.* at 2621-22. The SEC, however, is under no constraint even to consult with any person in the Executive Branch.

- Congress has no influence over the decisions of an independent counsel. *Id.* at 2620-21. In contrast, Congress has significant leverage over the SEC, and has historically exercised this leverage to intervene in the SEC's law enforcement process.[26]

These distinctions demonstrate that the delegation of civil law enforcement authority to the SEC impermissibly infringes on the President's executive power where the Ethics in Government Act did not. Most of them flow from the difference between a single-purpose prosecutor with a narrow portfolio and no institutional continuity, and a permanent government agency with the power to influence the development of the laws through a long-term enforcement agenda. The SEC has the ability to target areas of the law it wishes to influence by pressing particular positions before the judiciary. Over time, the SEC's enforcement decisions thus play a significant policymaking role in the development of an entire body of law. No such transfer of power to shape the law was implicated in *Morrison* because an independent counsel exercises discretion only over a single matter, and therefore "lack[s] policymaking . . . authority." 108 S. Ct. at 2619. Although the President's Article II powers may not be impaired significantly by the withdrawal of control over a few discrete cases, these powers *are* significantly undermined when the Executive Branch loses control over the process by which enforcement decisions shape an entire area of law.

Finally, the critical concerns which led to the enactment of the Ethics in Government Act have no parallel

---

[26] *See infra* note 42 and accompanying text.

in the federal securities laws. Congress perceived an apparent conflict of interest inherent in Executive Branch investigation of high-level presidential appointees that could be avoided only by appointment of an independent counsel. No similar justification exists for depriving the President of prosecutorial discretion over civil enforcement actions for federal securities violations.

The court of appeals upheld the validity of the SEC's independent law enforcement powers without any serious attempt at the analysis called for by *Morrison*. Instead, it found controlling this Court's decision in *Humphrey's Executor v. United States*, 295 U.S. 602 (1935). The court of appeals wrote: "We note that *Morrison* is predicated in part upon *Humphrey*, which stands generally for the proposition that Congress can, without violating Article II, authorize an independent agency to bring civil law enforcement actions where the President's removal power was restricted to inefficiency, neglect of duty, or malfeasance in office." App. 9a.

Morrison makes it clear that this approach was erroneous. In *Morrison*, this Court expressly repudiated the analytical framework of *Humphrey's Executor*.[27] In any event, *Humphrey's Executor* did not even by implication stand for the proposition stated by the court below. It decided *not* what specific powers the FTC could exercise as an independent agency, but whether the FTC as an entity was so imbued with executive power that Congress could not limit the President to "for cause" removal of Commissioners.[28] And *Humphrey's Executor* could not have decided the ability of independent agencies to bring

---

[27] *See* 108 S. Ct. at 2618; *see also id.* at 2636-37 (Scalia, J., dissenting) (noting majority's abandonment of *Humphrey's Executor* analysis).

[28] *See* 295 U.S. at 629; *cf.* Miller *Independent Agencies*, 1986 Sup. Ct. Rev. 41, 97 ("[The powers which an independent agency may exercise] need to be addressed on their own terms rather than being lumped together with the logically separate question of removal").

civil injunctive actions, because at that time the FTC did not have the power to bring any such action.[29] This Court was well aware at the time of the FTC's limited statutory duties, which the Court described as "no part of the executive power" but rather as being "quasi-legislative" and "quasi-judicial." 295 U.S. at 628. *Humphrey's Executor* provides no support for the grant to administrative agencies of independent law enforcement powers, a fact recognized when it was decided.[30]

The alternative rationale offered by the court below, purporting to apply *Morrison*'s separation of powers analysis, was equally unsatisfactory. The court found that the powers to appoint commissioners, to choose the Chairman of the SEC, and to remove commissioners for cause "give the President sufficient control over the commissioners to insure the securities laws are faithfully executed[.]" App. 10a. But only the narrowest conception of the scope of Presidential power reflected in Article II would find these limited controls over an otherwise totally independent agency sufficient to maintain

---

[29] The FTC's prosecutorial authority at the time of *Humphrey's Executor* was limited to petitioning the courts of appeals for enforcement of fully adjudicated administrative orders. *See* 295 U.S. at 620-21. An administrative hearing, of course, gives the respondent a fair opportunity to present evidence before a neutral arbiter, thereby eliminating the unfettered discretion in the enforcement decision. In contrast, the statute creating the FTC required that the Attorney General appear for the FTC in federal district court civil injunctive actions. 15 U.S.C. § 25 (1982). Not until 1973 did the FTC obtain authority to request a district court to enjoin a violation of its orders, *see* 15 U.S.C.A. § 45(m) (West Supp. 1988), 87 Stat. 592, Nov. 16, 1973, and not until 1975 did the FTC get general district court litigation authority, *see* 15 U.S.C.A. § 56 (West Supp. 1988), 88 Stat. 2199, Jan. 4, 1975. The FTC had accumulated various other limited grants of litigation authority between *Humphrey's Executor* in 1935 and 1975. *See, e.g.*, 15 U.S.C.A. § 53 (West Supp. 1988) (enjoining false advertising), 52 Stat. 114, Mar. 21, 1938.

[30] *See* Cushman, *The Constitutional Status of the Independent Regulatory Commissions*, 24 Cornell L.Q. 163, 176 (1939).

"the President's ability to perform his constitutional duty." *Id.*

The court of appeals did not dispute that the SEC makes its enforcement decisions entirely independently of the Executive Branch.[31] Indeed, the SEC's Canons of Ethics require that its members "reject any effort by representatives of the executive . . . to affect their independent determination of any matter[.]"[32] It is clear, then, that certainly as to each of the thousands of enforcement decisions made by the SEC (including the decision to bring the instant enforcement action against petitioners), and even as to the broad enforcement policies adopted by the SEC, the President has no input whatsoever.[33] This lack of presidential influence or control becomes more important as the SEC's international law enforcement efforts continue to expand.[34]

---

[31] Moreover, this Court has held that the enforcement decisions of independent agencies are immune from judicial review. *FTC v. Universal-Rundle Corp.*, 387 U.S. 244 (1967).

[32] 17 C.F.R. § 200.58 (1987).

[33] *See, e.g.*, Executive Order 12,291, *codified at* 3 C.F.R. 127 (1982) (exempting independent agencies from otherwise comprehensive presidential review of regulatory activity).

[34] *See U.K. Bank in Court Battle*, Fin. Times, Aug. 18, 1988 at 1 (accusing SEC of overstepping its jurisdiction); Widmer, *The U.S. Securities Laws—Banking Law of the World?*, 1 J. Comp. Corp. L. & Sec. Reg. 39 (1978) (same). *Cf. CFTC v. Nahas*, 738 F.2d 487, 490, 494-95 (D.C. Cir. 1984) (discussing Brazilian protests over attempted CFTC enforcement action); *FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson*, 636 F.2d 1300, 1325-27 (D.C. Cir. 1980) (discussing French protests over attempted FTC enforcement action). The SEC's proposed International Securities Enforcement Cooperation Act, part of which was incorporated into the recently enacted Insider Trading and Securities Fraud Enforcement Act of 1988, will increase the Commission's role in foreign relations still further. *See* S. 2544, 100th Cong., 2d Sess. (1988); H.R. 5133 § 6, 100th Cong., 2d Sess. (1988).

Moreover, the three powers focused upon by the court below do not provide the President any meaningful control. The appointments power, of course, is separately mandated in Article II and has never been regarded as an indicium of control in relation to broader separation of powers concerns.[35] But the court below also ignored the 1934 Act's limitations on the President's discretion over appointments, which were designed to limit the President's ability to influence the SEC. The five SEC commissioners serve staggered five-year terms, so it may be three years into a President's four-year term before he has named a majority of the Commission. Even then, only three members of the SEC may be members of the President's political party. *See* 15 U.S.C.A. § 78d (West Supp. 1988).

The power to determine which commissioner will be SEC Chairman may have some value on matters over which the Chairman has control or exercises special influence. But in voting on enforcement matters, the Chairman's vote has no more weight than any of the other four commissioners. *See* 15 Fed. Reg. 3175 (1950). The President's power to designate the Chairman of the SEC surely cannot be understood to give the President any measurable degree of control over the SEC's enforcement decisions.[36]

Nor can the removal power play any role in a President's effort to affect SEC law enforcement decisions or policies. The 1934 Act makes no provision for removal

---

[35] *See Bowsher v. Synar*, 478 U.S. 714, 727-28 (1986) (Controller General, though appointed by President, is under control of Congress); *Myers v. United States*, 272 U.S. 52, 121-22 (1926).

[36] One former Chairman of the SEC has stated that the President should never be consulted in advance of the Commission's decision to bring a case. *See* W. Cary, *Politics and the Regulatory Agencies* 18 (1967). *Cf. Reaganite Regret: SEC Chief Is Just a Regulator Guy*, Wall St. J., July 8, 1988 at 14 col. 3 (describing conflict between SEC Chairman and President over initiatives in response to October 1987 stock market crash).

of SEC commissioners, and the SEC may even contend that the President has no removal power, even for cause.[37] But even assuming the President may remove a Commissioner for "inefficiency, neglect of duty or malfeasance in office," [38] these limited grounds for removal provide no means of exercising influence over avowedly discretionary decisions. This Court has recognized on a number of occasions that a for-cause limitation on removal is designed to *insulate* appointees from Presidential influence, not to provide the means for such influence.[39]

What the court below failed to appreciate is the fact that the SEC, like other independent agencies, is structured to be totally independent of the President in its decision-making. Only through judicial alchemy can the elements Congress chose to assure independence of the SEC be converted into manifestations of Presidential control.

Just as the court below substantially overstated the degree of influence the President has over the SEC, it erred by failing to examine the extent to which *Congress* exerts influence over the SEC's law enforcement decisions. The independent counsel's insulation from Congress was a key aspect of the Court's analysis in *Morrison*.[40] This Court has repeatedly struck down legislative schemes through which Congress increased its own influence over executive decisions at the expense of the

---

[37] No SEC commissioner has ever been removed by the President.

[38] L. Loss, *Securities Regulation* 1882 (2d ed. 1961); *Report of the House Committee on Interstate and Foreign Commerce on the Independent Regulatory Agencies Act of 1960*, H.R. Rep. No. 2070, 86th Cong., 2d Sess. 14 (1960).

[39] *See Humphrey's Executor*, 295 U.S. at 625-26, 629-30; *Wiener v. United States*, 357 U.S. 349, 356 (1958); *Bowsher*, 478 U.S. at 738-39 (Stevens, J., concurring); *id.* at 770 (White, J., dissenting).

[40] *See* 108 S. Ct. at 2620 ("Congress retained for itself no powers of control or supervision over an independent counsel").

President.[41] Unlike an independent counsel, the SEC is dependent on, and accountable to, the Congress.

The influence of Congress over the SEC is far greater than that of the President. Congress controls the SEC's budget and engages in continuing oversight of the Commission. Through this process, Congress addresses directly the SEC's enforcement policies and attempts to influence specific law enforcement decisions.[42] This factor alone warrants reexamination by this Court of the lower court's conclusion that the SEC's enforcement powers are consistent with the Court's opinion in *Morrison*.

---

[41] *See Bowsher*, 478 U.S. at 727; *Myers v. United States*, 272 U.S. 52 (1926); *Buckley v. Valeo*, 424 U.S. 1 (1976); *INS v. Chadha*, 462 U.S. 919, 958 (1983).

[42] *See* App. 92a-97a (letters of Cong. John Dingell to SEC Chairman John Shad urging commencement of SEC enforcement actions concerning WPPSS bond default); *SEC Votes to Sue Ashland, Ex-Aide in Bribery Case*, Wall St. J., April 2, 1986 at 14 col. 4 (SEC reverses itself and votes to bring enforcement action after Congressional pressure) (*see* SEC Lit. Rel. No. 11150, July 8, 1986); *SEC and Citicorp: Hearings Before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce*, 97th Cong., 2d Sess. (1982) (concerning SEC's failure to bring enforcement action for alleged irregular foreign exchange transactions) (*see* SEC Rel. No. 82-19, March 5, 1982); *cf. SEC v. Wheeling-Pittsburgh Steel Co.*, 648 F.2d 118 (3d Cir. 1981) (en banc) (Congressional pressure triggers SEC investigation). *See also* 103 Cong. Record 7512 (1957) (Senator Carroll: "Is the Securities and Exchange Commission an arm of Congress?" Senator Kefauver: "The Securities and Exchange Commission is an arm of Congress, charged with the duty of enforcing and carrying out . . . the Securities and Exchange Act").

Congress often influences the prosecutorial decisions of other independent agencies as well. *See Ameron, Inc. v. United States Army Corps of Engineers*, 809 F.2d 979, 991 n.8 (3d Cir. 1986) (citing examples of Congressional interference with enforcement actions of FTC), *cert. dismissed*, No. 87-163 (Oct. 19, 1988); *Pillsbury Co. v. FTC*, 354 F.2d 952 (5th Cir. 1966) (denying enforcement of FTC order because of excessive Congressional interference in enforcement decision).

The extent and focus of federal economic regulation has in recent years played a major role in American politics, and legitimately so. A President who is elected in part because of views on these issues should have the power, within the confines of laws passed by Congress, to use his discretion to shape the regulatory environment. Much of what a President can accomplish depends on congressional agreement to a legislative program. But the President is also entitled, in the fulfillment of his duties to the public, to exercise the discretion inherent in the constitutional grant of power to execute the laws. Each time Congress diminishes that power, it undercuts the intent of the Framers to subject executive decisions to the sanctions of the democratic process.[43]

In the 1934 Act, Congress removed from the President's control law enforcement decisions relating to the conduct of the Nation's financial markets. In other statutes, it has withdrawn from the President like powers relating to the Nation's commodities markets, trade practices, consumer products, thrift institutions, and interstate transportation. Petitioners urge the Court to consider and determine the validity of these intrusions into the Executive power.[44]

---

[43] *See The Federalist* No. 70, at 363 (Hamilton) (Beloff ed. 1987) (Divided executive responsibility "tends to deprive the people of the two greatest securities they can have for the faithful exercise of any delegated power. *First*. The restraints of public opinion, which lose their efficacy . . . on account of the uncertainty on whom it ought to fall; and *secondly*, the opportunity of discovering with facility and clearness the misconduct of the persons they trust").

[44] As the court of appeals implicitly (and correctly) held, the constitutionality of the SEC's unfettered enforcement power is properly before the Court at this time. If the SEC had no power to bring the action which resulted in the instant injunction, then the district court had no subject-matter jurisdiction to enter that injunction and has no continuing jurisdiction to enforce that injunction. *See Thompson v. Tolmie*, 27 U.S. (2 Pet.) 157, 163 (1829) (judgment outside of court's jurisdiction subject to collateral attack).

CONCLUSION

For all of the foregoing reasons, petitioners urge the Court to grant their petition for a writ of certiorari.

Respectfully submitted,

ARTHUR F. MATHEWS *
ANDREW B. WEISSMAN
W. HARDY CALLCOTT
LEE T. LAURIDSEN
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000
Counsel for Petitioners

* Counsel of Record

Of Counsel:
ALAN C. JACOBSON, P.C.
P.O. Box 3115
Englewood, Colorado 80115

November 22, 1988

APPENDIX

APPENDIX

[reported at 855 F.2d 677]

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 86-2319

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,
v.
BLINDER, ROBINSON & CO., INC.,
Defendants-Appellants.

Aug. 24, 1988

Jacob H. Stillman (Daniel L. Goelzer, Gen. Counsel, Colleen P. Mahoney, Asst. Gen. Counsel, Thomas L. Riesenberg, Sp. Counsel, Robert H. Rosenblum, Atty., Paul Gonson, Sol., of counsel, on the briefs), S.E.C., Washington, D.C., for plaintiff-appellee.

Arthur F. Mathews (Andrew B. Weissman, Steven W. Preston, and Karen A. Getman of Wilmer, Cutler & Pickering, Washington, D.C., Philip E. Lowery, Denver, Colo., and Alan C. Jacobson, Englewood, Colo., with him on the briefs), of Wilmer, Cutler & Pickering, Washington, D.C., for defendants-appellants.

Before MCKAY and BRORBY, Circuit Judges, and PARKER,* District Judge.

---

* The Honorable James A. Parker, United States District Judge for the District of New Mexico, sitting by designation.

BRORBY, Circuit Judge.

Blinder, Robinson and Co., Inc. and Meyer Blinder both appeal the orders of the United States District Court denying appellants' motions to vacate an injunction.

Appellant Blinder, Robinson and Co., Inc. (Blinder, Robinson) is a nationwide broker/dealer in securities. Appellant Meyer Blinder was a founder, and at all times relevant herein, was and is Blinder, Robinson's principal shareholder and president. In 1982, the United States District Court for the District of Colorado, following trial, found the Blinder, Robinson sales force practiced a program of disseminating "deliberately deceptive misinformation," orchestrated by Mr. Blinder. The court specifically found that Mr. Blinder had acted with an "intent to deceive" investors. Based upon these and other findings, the district court entered injunctions prohibiting appellants from engaging in specified practices in violation of various provisions of securities law. The injunctions can be described as ordering appellants to obey the law. Upon appeal, this court affirmed the decision of the district court in an unreported decision in September 1983. Appellants thereafter filed an action against the Securities and Exchange Commission (SEC) seeking an injunction, declaratory relief and damages. This action was predicated in part upon a continuing investigation by the SEC. Another theory of this action was that appellants were represented by incompetent or negligent counsel in the original enforcement action. This court sustained the trial court's decision which denied relief to appellants. *Blinder, Robinson & Co. v. United States Sec. & Exch. Comm'n*, 748 F.2d 1415 (10th Cir.1984), *cert. denied*, 471 U.S. 1125, 105 S.Ct. 2655, 86 L.Ed.2d 272 (1985).

In May 1986, appellants filed a motion with the district court to vacate the injunction. This motion was accompanied by affidavits, exceeding several hundred pages,

by which appellant Blinder sought to demonstrate: (1) Blinder, Robinson has grown dramatically and prospered financially; (2) appellants are generous and have supported many philanthropies; (3) most of the key management, with the exception of Mr. Blinder, who remains the president, has been changed; (4) future violations of securities law are highly unlikely due to sweeping changes in personnel and procedures; and, (5) based solely upon the district court's injunction and the underlying findings, eleven states have attempted to sanction Blinder, Robinson, the result of which has taken a toll on the firm, its officers, representatives, employees, and thousands of wholly innocent persons, these innocent persons being Blinder, Robinson's stockholders. The appellee filed nothing contravening the appellants' affidavits.

In July 1986, the district court denied appellants' Motion to Vacate the Injunction finding, *inter alia*, that Mr. Blinder remained in control of Blinder, Robinson and was not fully aware of his own fault in this case; that the court was well aware of the authority of the SEC and the state regulatory authorities to take further action based on the injunction at the time the injunction was issued; that demonstrated philanthropy has nothing to do with the case; that no extreme and unexpected harm was shown; and, that the court could not say the public no longer needs the protection of the injunction. The court thereupon entered its order denying appellants' motion to vacate the injunction. Appellants then filed a motion for reconsideration and raised constitutional questions regarding the authority of the SEC to appear before the court as plaintiff. The court denied this motion.

Appellants appeal these rulings of the district court, and claim: (1) the district court applied an excessively rigid standard for the dissolution or modification of the injunction; and (2) the civil prosecution of appellants in this case by the S.E.C., without any participation by

the Executive Branch, violated the constitutional doctrine of separation of powers.

We will consider these issues *seriatim*.

I

Motion to Vacate Injunction

Motions to vacate injunctions lie within the discretion of the trial court, and the disposition below will not be disturbed on appeal in the absence of an abuse of discretion. *Securities & Exch. Comm'n v. Thermodynamics, Inc.*, 464 F.2d 457, 459, (10th Cir.1972), *cert. denied* 410 U.S. 927, 93 S.Ct. 1358, 35 L.Ed.2d 588 (1973). We will examine the issues raised under an abuse of discretion standard.

The appellants first argue that the trial court abused its discretion by applying the virtually impossible standard set forth in *United States v. Swift & Co.*, 286 U.S. 106, 52 S.Ct. 460, 76 L.Ed. 999 (1932), where in an opinion written by Justice Cardozo the Supreme Court held the standard to be used in deciding whether to vacate an injunction requires a clear showing of a grievous wrong evoked by new and unforeseen conditions. *Id.* at 119, 52 S.Ct. at 464. Appellants contend the trial court should instead apply the standards set forth in *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 88 S.Ct. 1496, 20 L.Ed.2d 562 (1968), wherein the Supreme Court held that an injunction may be changed if the facts and circumstances prevailing at the time of the issuance of the injunction have changed or new ones have arisen.

This court has been called upon many times to decide whether the standards of *Swift* remain applicable. *See Dowell v. Board of Educ. of Okla. City Pub. Schools*, 795 F.2d 1516 (10th Cir.), *cert. denied* 479 U.S. 938, 107 S.Ct. 420, 93 L.Ed.2d 370 (1986); *EEOC v. Safeway Stores, Inc.*, 611 F.2d 795 (10th Cir.1979), *cert. denied*,

446 U.S. 952, 100 S.Ct. 2918, 64 L.Ed.2d 809 (1980); *Securities and Exchange Comm'n v. Jan-Dal Oil & Gas, Inc.*, 433 F.2d 304 (10th Cir.1970); *Ridley v. Phillips Petroleum Co.*, 427 F.2d 19 (10th Cir.1970); *Coca-Cola Co. v. Standard Bottling Co.*, 138 F.2d 788 (10th Cir. 1943). In all of these cases, we applied the standards of *Swift*. In *Thermodynamics*, 464 F.2d at 460, we set forth the requirements of *Swift*:

> [*Swift*] presents a difficult and perhaps severe requirement, but changes in injunctions must be based on some substantial change in law or facts. The injunction was entered based upon the then existing state of the law and upon the then existing facts. The finality of such proceedings, or granting of remedy, requires a showing of change. This is what *Swift* requires.

We conclude the trial court utilized the correct standard of law in its analysis of this case.

Appellants argue they have been heavily burdened by the injunction, and point to a barrage of state and federal regulatory actions. The trial court's response to this contention was that it was cognizant of these consequences when the injunction was issued. The trial court understood that *Swift* requires clear proof of *unforeseen* conditions, prior to vacating an injunction, and correctly ruled that Blinder, Robinson and Mr. Blinder failed to meet that burden of proof.

Appellants next contend the trial court abused its discretion in arbitrarily deciding not to credit the unrefuted evidence of rehabilitation. They argue there was no basis for the trial court to conclude that Mr. Blinder was not fully aware of his past mistakes and therefore might repeat them. We would note the trial court carefully considered the steps taken by Blinder, Robinson to ensure the firm's future compliance with securities laws and balanced this against the court's finding that Mr.

Blinder continued to control the company. In response to the affidavit of Mr. Blinder, the trial court stated:

> I am not sure he [Mr. Blinder] still understands what happened here. There is a tendency once again to say, well, I made a mistake, I should have asked for a written opinion. . . . That isn't the reason for the injunction. There was a disregard not just for the opinions of counsel, but a disregard of the requirements of the law.
>
> And Mr. Blinder remains in control of this organization. . . . Mr. Blinder . . . is not fully aware of his own fault in this case and one of the reasons . . . for the injunction against his firm.

The trial court noted that the interest to be protected by the injunction was a public interest (i.e., the integrity of the securities industry), and the reason for the injunction was the ability of the enforcement agency to come to court and show a violation and to then have available the quick remedy of contempt.

Mr. Blinder's own affidavit further supports the conclusions of the trial court: "I, *Meyer Blinder*, have been and continue to be President, Chief Executive Officer, and a Director. I exercise overall executive authority." In explaining the original violations, Mr. Blinder continued: "I did not request a formal, written legal opinion from counsel . . . and I now feel the failure to do so was a significant mistake by me." Couple this sworn statement with the trial court's original findings that Mr. Blinder made a business decision contrary to the advice of the attorney and a specific finding of "intent to deceive, manipulate, or defraud," and it becomes quite evident that the record supports the conclusions of the trial court. The trial court did not arbitrarily reject the evidence of rehabilitation. In view of the record, we cannot say the trial court abused its discretion in refusing to vacate or modify the injunctions.

II

The Constitutional Issue

Appellants argue that the power of the SEC to commence a civil enforcement action in federal court is in violation of the separation of powers principle. Appellants contend that the SEC is an independent agency empowered to enforce federal law by means of civil actions for injunctions, and that the President is given sole and exclusive control over the execution of the laws under Article II of the Constitution which provides that the President shall "take care the laws be faithfully executed."

The trial court held the SEC may constitutionally exercise civil enforcement authority. This is a conclusion of law which we review *de novo*. *Boise City Farmers Coop. v. Palmer*, 780 F.2d 860, 866 (10th Cir.1985).

A brief overview of the SEC will be helpful in understanding the constitutional issue presented. The creation, composition, and powers of the SEC are found in the Securities Exchange Act of 1934. The commission consists of five members who are appointed by the President with the advice and consent of the Senate. The terms of the commissioners are staggered and the basic length of each term is five years. No more than three of the commissioners may be members of the same political party. The statute does not provide for a chairman. Until 1950, the Chairman was elected annually. Following Reorganization Plan No. 10 of 1950 (*see*, Reorganization Act of 1949, 5 U.S.C. §§ 901-913), the President designates the chairman. Pursuant to this Reorganization Plan, the chairman succeeded to most of the executive and administrative functions of the commission. The Act does not expressly give to the President the power to remove a commissioner. However, for the purposes of this case, we accept appellants' assertions in their brief, that it is commonly understood that the President may remove a

commissioner only for "inefficiency, neglect of duty or malfeasance in office." While the SEC must transmit evidence of criminal misconduct to the Attorney General, there can be no doubt the SEC is authorized to institute civil actions in the federal district courts to enforce various security laws.

Several conclusions can be drawn from this brief overview. First, as the President has the power to choose the chairman of the SEC from its commissioners to serve an indefinite term, it follows that the chairman serves at the pleasure of the President. Second, as the chairman controls key personnel, internal organization, and the expenditure of funds, the chairman exerts far more control than his one vote would seem to indicate. Third, it can safely be assumed that in exercising his power of appointment, even as to commissioners who are not members of his party, the President will tend to appoint those persons who are sympathetic to his own views.

In *Humphrey's Executor v. United States*, 295 U.S. 602, 55 S.Ct. 869, 79 L.Ed. 1611 (1935), President Roosevelt requested Humphrey's resignation as a commissioner of the Federal Trade Commission for the reason that Humphrey and the President had differing policies concerning the administration of the commission. The statute provided that a commissioner could be removed "for inefficiency, neglect of duty, or malfeasance in office." The Supreme Court recognized the intent of Congress to create a commission that was not to be subject to anyone in the government—a body which should be independent of executive authority, *except in its selection*, and ruled that the concept of a member continuing in office at "the mere will" of the President might thwart the very ends Congress sought to realize. The Supreme Court next turned its attention to the question of whether such a limitation on the President's right to remove a commissioner is constitutional under the principles of separation of powers. The Court held that whether the power of the

President to remove an officer shall prevail over the authority of Congress to condition the power by fixing a definite term and precluding removal except for cause, will depend upon the character of the office. The Court concluded "as to officers of the kind here under consideration" no removal can be made except as provided by statute. The Supreme Court noted the ruling would be equally applicable to members of the Interstate Commerce Commission. Both the FTC and the SEC are administrative bodies created by Congress to carry into effect legislative policies embodied in the statute. We conclude the same reasoning would apply to commissioners of the SEC.

More recently, in *Morrison v. Olson*, —— U.S. ——, 108 S.Ct. 2597, 101 L.Ed.2d 569 (1988), the Supreme Court decided the constitutionality of the independent counsel statutes. The law in question there provides for the appointment of an independent counsel to investigate and prosecute certain government officials for violations of federal criminal law. The law in question generally provides that upon receipt of specified information, the court shall appoint independent counsel. An independent counsel may be removed, other than by impeachment and conviction, only by the Attorney General and only for good cause, physical disability, or mental incapacity.

We note that *Morrison* is predicated in part upon *Humphrey*, which stands generally for the proposition that Congress can, without violating Article II, authorize an independent agency to bring civil law enforcement actions where the President's restrictions impede the President's ability to perform his constitutional duty. It is a matter of fundamental law that the Constitution assigns to Congress the power to designate duties of particular officers. The President is not obligated under the Constitution to exercise absolute control over our government executives. The President is not required to execute the laws; he is required to take care they be executed

faithfully. The President has the power to appoint the commissioners; he has the power to choose the chairman of the SEC who has broad powers concerning the operation and administration of the commission; the chairman serves at the President's pleasure; and, the President has the power to remove a commissioner for inefficiency, neglect of duty, or malfeasance in office. We conclude these powers give the President sufficient control over the commissioners to insure the securities law are faithfully executed and the removal restrictions do not impede the President's ability to perform his constitutional duty.

We conclude the trial court correctly applied the proper legal standard concerning the vacation or modification of the injunction. We further conclude the civil enforcement power given to the SEC is constitutionally valid. We have carefully considered all issues raised by appellants, and those not discussed herein are found to be without merit.

For the reasons set forth herein, the judgment of the trial court is AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 80-M-1125

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

BLINDER, ROBINSON & CO., INC., and MEYER BLINDER,
Defendants.

ORDER DENYING DEFENDANTS' MOTION FOR RECONSIDERATION OF MOTION TO VACATE INJUNCTION

Upon consideration of a motion, filed July 25, 1986, designated Defendants' Motion For Reconsideration Of Motion To Vacate The Injunction, and the memorandum of points and authorities filed in support thereof, and it being the pivotal argument of the defendants that the Securities and Exchange Commission is an independent agency over which the President has no authority, and that under the Constitution the determination of cases to be brought into the United States courts is exclusively an Executive Branch power, and this court having carefully considered that argument, and the opinion of the Supreme Court in *Bowsher v. Synar*, 54 U.S.L.W. (July 7, 1986), this court concludes that the argument is without merit. Accordingly, it is

ORDERED, that the Defendants' Motion For Reconsideration Of Motion To Vacate The Injunction is denied.

Dated: July 29, 1986

BY THE COURT:

/s/ Richard P. Matsch
RICHARD P. MATSCH
Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 80-M-1125

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

BLINDER, ROBINSON & CO., INC., and MEYER BLINDER,
Defendants.

ORDER DENYING MOTION FOR NEW TRIAL

On July 21, 1986, the defendants filed a Motion For New Trial And/Or Rehearing, And/Or Reconsideration, together with a motion for enlargement of time. The motion for enlargement of time was withdrawn. Upon consideration of the motions for new trial, rehearing and reconsideration, the court concludes that the motions are without merit, and it is, accordingly,

ORDERED, that the Motions For New Trial And/Or Rehearing, And/Or Reconsideration are denied.

Dated: July 29, 1986

BY THE COURT:

/s/ Richard P. Matsch
RICHARD P. MATSCH
Judge

Case Number: 80-M-1125

I certify that I mailed a copy of the attached to the following:

Dated: July 29, 1986

JAMES R. MANSPEAKER
Clerk
By: /s/ Jacob Gilmore
JACOB GILMORE
Deputy Clerk
TERRI A. SMETHERS
Secretary

Alan C. Jacobson
P.O. Box 3115
Englewood, CO 80155

Arthur F. Mathews
Charles E. Davidow
Richard F. Goodstein
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D.C. 20006

Philip E. Lowery
110 Sixteenth Street
Denver, CO 80202

Rodney K. Vincent
Securities & Exchange Commission
410 Seventeenth St., Ste. 700
Denver, CO 80202

Larry R. Lavoie
John E. Birkenheier
Securities & Exchange Commission
450 Fifth St., N.W., Stop 6-6
Washington, D.C. 20549

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 80-M-1125

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

BLINDER, ROBINSON & CO., INC., and MEYER BLINDER,
Defendants.

ORDER DENYING MOTION TO VACATE INJUNCTION

For the reasons set forth by the court at the conclusion of the hearing held this day on the Defendants' Motion to Vacate Injunction, filed May 5, 1986, it is

ORDERED, that the motion to vacate injunction is denied.

Dated: July 11, 1986

BY THE COURT:

/s/ Richard P. Matsch
RICHARD P. MATSCH
Judge

Case Number: 80-M-1125

I certify that I mailed a copy of the attached to the following:

Dated: 11 July 1986

JAMES R. MANSPEAKER
Clerk

By: /s/ Jacob Gilmore
JACOB GILMORE
Deputy Clerk
TERRI A. SMETHERS
Secretary

Alan C. Jacobson
P.O. Box 3115
Englewood, CO 80155

Arthur F. Mathews
Charles E. Davidow
Richard F. Goodstein
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D.C. 20006

Philip E. Lowery
110 Sixteenth Street
Denver, CO 80202

Rodney K. Vincent
Securities & Exchange Commission
410 Seventh St., Ste. 700
Denver, CO 80202

Larry R. Lavoie
John E. Birkenheier
Securities & Exchange Commission
450 Fifth St., N.W., Stop 6-6
Washington, D.C. 20549

[1]

IN THE UNITED STATES DISTRICT COURT
IN THE DISTRICT OF COLORADO

Civil Action No. 80-M-1125

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

vs.

BLINDER, ROBINSON & CO., INC. and MEYER BLINDER,
Defendants.

REPORTER'S TRANSCRIPT OF PROCEEDINGS
IN HEARINGS ON DEFENDANTS' MOTION
TO VACATE INJUNCTION

EXCERPT OF PROCEEDINGS—RULING BY
THE COURT

Proceedings held before the Honorable Richard P. Matsch, United States District Judge, for the District of Colorado, on the 11th day of July, 1986, at the hour of 1:30 p.m., in Courtroom A, United States Post Office Building, Denver, Colorado.

APPEARANCES:

On behalf of the Plaintiff,

LARRY R. LAVOIE, ESQ.
Office of General Counsel
Securities & Exchange Commission
450 Fifth Street, N.W., Stop 6-6
Washington, D.C. 20549

THOMAS J. AMY, ESQ.
RODNEY K. VINCENT, ESQ.
Regional Counsel
Securities & Exchange Commission
Denver Regional Office
410 Seventeenth Street
Denver, Colorado 80202

[2]

On behalf of the Defendants,

ARTHUR E. MATHEWS, ESQ.
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D.C. 20006

PHILIP E. LOWERY, ESQ.
Philip E. Lowery, P.C.
110 Sixteenth Street
Denver, Colorado 80202

Of counsel:

ALAN C. JACOBSON, ESQ.
Alan C. Jacobson, P.C.
P.O. Box 3115
Englewood, Colorado 80155

COURT REPORTER: Catherine C. Stevens, RPR
P.O. Box 3958
Evergreen, Colorado 80439-3430

(Proceedings recorded by mechanical stenotype and transcribed by typing)

AFTER HEARING ORAL ARGUMENT, THE COURT RULED AS FOLLOWS:

THE COURT: Well, I have, as I indicated coming in this afternoon, reviewed these affidavits and the briefs and, most particularly, I went back and read my findings of facts and conclusions of law and the injunction which is at issue herein, and the memorandum and opinion and order of June 8, 1982.

Mr. Lowery makes mention that there was 10 or 11 months between the time of the trial and the time of that written opinion. And, of course, that delay was unfortunate in part, but it simply reflects a detailed evaluation of the [3] evidence in this case.

This was a contested case, hotly contested, which is as it should be. I find no fault with a defendant defending itself. And I have to be candid with you in this case, I have attempted to reconstruct somewhat my thinking that isn't entirely reflected in the opinion, perhaps.

But the issue which is before me here is, as counsel for both sides have pointed out, first whether there is extreme and unexpected harm resulting from that continuing injunction as a permanent order and, second, whether there is really any need for it any more. Now, whether you use the rhetorical phrase that the dangers have attenuated to a shadow, or whatever, the question is, is there a need for it.

Now, what was the need for it when it was entered, let's talk about that in the first instance.

This was an enforcement case, this was not a case in which we were looking to recover damages by anybody. And the remedy that the Court imposed was, therefore, the prospective remedy of an equitable injunction, and the interest attempted to be protected is the public interest, a particular part of the public interest, which is the integrity of the securities industry.

I have a high regard for the securities industry. It is, after all, through the activities of those who make invest-

ment opportunities available to the public that we have capital formation in the United States and that we are able to fund the many enterprises that deliver us payrolls and keep the country afloat. So it is, as I think I have expressed it on some other occasion, it is America's gain, without any question.

Now, the game has to be played strictly according to the rules. We have had a time or two in this country when it wasn't played—well, we didn't have the rules and we know what happened when we didn't have the rules. So there was great importance placed on the development of the Securities Acts 33 and 34, and the regulatory agency that has authority in this field for the Federal Government. And there was a time in my past, when in the practice of law, I challenged the authority of the SEC on behalf of broker/dealers myself.

Now, Mr. Lowery refers to the way in which the injunction was structured. It is true, in large part, in later paragraphs, particularly Paragraphs 6 through 9, were pretty well directed towards the kind of offering that was involved in American Leisure, the best efforts—or an all-or-none, rather, offering. But I also use the language in 1 through 4, the basic "don't disobey the law" language that you see in all of the SEC injunctions, the consent injunctions, and particularly, of course, the restrictions against employing devices, schemes or artifices to defraud, and the rest.

Now, those things are the law, anyway. But the reason that we have them as an injunction, is for the extra protection that is involved in the ability of the enforcement agency to come to court to show a violation, and the quick remedy of contempt—well, it isn't a quick remedy, because those hearings can last a long time, too, because the defendant is entitled to full due process on that. That's one of the reasons, it is to have available to the enforcement agency the mechanism of coming to court in a hurry and seeking relief.

There is another aspect to an injunctive order, however, and that is, hopefully, it is used by those who are subject to it as a reminder of what the law is and as a guiding principle within the organization.

One thing that I have thought of putting in injunctions since the time of this, is to require that it be read by all those who come on board and work for the firm, because that is part of what we are trying to do, is to educate those who have the responsibility and the authority to act as to what they are required to do.

Now, it is not like a case of probation, you know, in a criminal case, where you are talking about terminating probation and a probationer comes in and says I've been a good fellow now for three years and you still [6] have me going for two, why don't you cut me loose? I don't think that's the issue, because it isn't just a question of whether the defendants are good fellows.

And in my view of it, it doesn't make really any difference to me how much philanthropy has been demonstrated. I'm not interested in how many contributions have been made to what kinds of charities. That has nothing to do with my responsibility, which is to protect the integrity of the securities market to the extent that it is brought before me in specific cases and controversies like this one.

Now, I have reviewed very carefully Mr. Blinder's affidavit. I do so because I said some pretty blunt and harsh things about Mr. Blinder in this opinion. And I have reviewed it. I stand behind those things, they were demonstrated by the evidence, and those findings were, of course, also affirmed on appeal.

What troubles me about Mr. Blinder's affidavit is, that I am not sure he still understands what happened here. There is a tendency once again to say, well, I made a mistake, I should have asked for a written opinion. There is a flavor to it, in my judgment, that says, well, I didn't dot the i's and cross the t's and that was a mistake.

That isn't the reason for the injunction. There was a disregard not just for the opinions of counsel, but a disregard of the requirements of the law.

And Mr. Blinder remains in control of this organization. Now, I'm not saying this in some kind of perjorative way or punitive way, but I'm saying in terms of looking to whether there is any continuing reason for the injunction, there is. And one of the continuing reasons for the injunction is Mr. Blinder is still in control of this organization and, in my judgment, is not fully aware of his own fault in this case and one of the reasons, a principal reason, for the injunction against his firm.

I have reflected on this, whether there is extreme and unexpected harm involved. And I am of the view that the perspective for that is mine, not the Defendants', because it is a question of whether when I signed my name to what is a very serious order here, which has far reaching consequences, whether there have been now shown consequences of which I had no inclination. That isn't shown.

I am well aware of the authority of the SEC to take further action based on an injunction, I was well aware of it then. I am also well aware of the state regulatory authorities and the multiple laws that the states have. But I think we have to exercise the discipline of staying within our own roles.

My role in this matter has been as a District Court Judge in this Federal District to hear and decide the complaints brought against these Defendants and the structure [8] of remedies that was consistent with the fault found, the violations found. I have done that.

It is the responsibility of the regulatory agencies in the various states in which this company does business to make their own judgments and decisions consistent with their laws and one would hope with due process of law, in determining what is required in the interest of the people of the various states. It is the responsibility

of the SEC to make its own determinations with respect to whether other discipline should be taken.

Now, I would expect, as I have indicated in my colloquy with all counsel, that the Defendants are fully capable of going forward with the appeal before the Commission and, if necessary, on appellate review, if there has been a too punitive approach, an unfair use, as it were, of the injunction. But here again, you know, we can't wipe the slate clean, I can't unfind the facts or unconclude the law. The firm did it, Meyer Bliner did it, that stands on the record and never will be changed.

Therefore, the fact that there was an injunctive order entered at one time, will not change. I suppose the only thing that would change is if I now were to say, well, I think everything is fine now and there has been rehabilitation, you could use that to—I mean by "you," the Defendants—to attenuate the stigma and the effect in arguing before other agencies.

But what is at the bottom line, is whether sitting here in Colorado, I can say that the public no longer needs the protection of my order. And I can't say that, and because I can't say that, the motion is denied.

Anybody have anything further?

MR. MATHEWS: Your Honor, if I may add one thing.

We noted in our memorandum and in our motion that the recent case involving Gramm-Rudman might raise some issues that would be different from these issues.

THE COURT: Well, they are not before me, Mr. Mathews, if you are talking about the constitutionality of the SEC and its abiilty to function.

MR. MATHEWS: No, I'm not talking about that. I'm talking about something much more narrow that we have had—as you know, the decision came out a few days ago, and that we had planned to file a supplemental memo on a much more narrow ground. That much more narrow ground is not that the SEC is unconstitutional, but the ground that the effect of the

separation of powers, constitutional analysis in that case, may bear upon whether the SEC can exercise executive enforcement as opposed to the proper adjusters.

THE COURT: I don't see how that is raisable under a Motion to Vacate an Injunction.

MR. MATHEWS: If the party seeking the injunction has under the constitution no authority to seek it, we would take the position that it would be a basis for the Court to vacate—

THE COURT: You may do what you choose to do, and consistent with your understanding of the law and the ethics applicable to the conduct of counsel, but it is not before me. I am ruling on what is before me and I have ruled that the Motion to Vacate the Injunction is denied.

MR. MATHEWS: I would just like your Honor to be aware that—

THE COURT: That you might shoot another one over the bow?

MR. MATHEWS: That is, if we determine that there is a legal argument that's applicable.

THE COURT: Well, it would have to be the subject of a new pleading of some type.

Court is in recess.

(2:37 p.m.—the hearing concluded)

CERTIFICATE OF REPORTER

I, Catherine Carroll Stevens, do hereby certify that the foregoing Pages 1 through 10, are a complete, accurate and true excerpt of proceedings of only the Court's ruling rendered on July 12, 1986, in the matter of the Securities and Exchange Commission vs. Blinder, Robinson & Co., Inc. and Meyer Blinder, Case No. 80-M-1125.

CATHERINE C. STEVENS, RPR
P.O. Box 3958
Evergreen, CO 80439

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 80-M-1125

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

vs.

BLINDER, ROBINSON & CO., INC.; MEYER BLINDER; *et al.*,
Defendants.

MEMORANDUM OPINION AND ORDER

[Filed June 8, 1982]

MATSCH, Judge

This is a civil enforcement action against Blinder, Robinson & Co., Inc. (Blinder-Robinson), a registered broker-dealer, and Meyer Blinder (Blinder), its president and principal shareholder. The plaintiff's allegations of violations of federal securities laws and regulations all concern offers to sell, sales and delivery after sales of a registered offering of 10 million units of common stock and warrants issued by American Leisure Corp. (American Leisure), a New Jersey corporation, which was a wholly-owned subsidiary of Beef & Bison Breeders, Inc. (BBB).

The SEC brought this action pursuant to Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b) (1976), and Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d) (1976). This court has jurisdiction of the action under Section 22(a) of the 1933 Act, 15 U.S.C. § 77v(a) (1976), and Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1976). Venue in this court

is proper: Blinder-Robinson is located and does business within the State of Colorado, Blinder resides in the state, and many of the acts alleged in the SEC's complaint occurred within the state.

The complaint alleged violations of the anti-fraud provisions of both Securities Acts, Section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976), Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b) (1976), and of Rules 10b-5, 6 and 9 promulgated thereunder, 17 C.F.R. §§ 240.10b-5, 6, 9 (1981); it also alleged violations of Section 15(c) of the 1934 Act, 15 U.S.C. § 78o(c) (1976), which prohibits fradulent [sic] acts by brokers, and of Rule 15c2-4 promulgated thereunder, 17 C.F.R. § 240.15c2-4 (1981). The Commission seeks an injunction against future violations of these sections and rules.

In addition to Blinder-Robinson and Blinder, the SEC originally named the following corporations and individuals as defendants in this action: American Leisure, Cavanagh Communities Corp., Scope, Inc., Nathan S. Jacobson, Irwin S. Lampert, Joseph Klein, and Leon Joseph. These defendants all have entered into consent decrees with the SEC, and no longer are active parties in this litigation.

FACTS

The offering was on a "best efforts, all or none basis." For a unit price of $2.50, the purchaser received one share of American Leisure common stock; one Class A Warrant (two of which entitled the holder to purchase one share of common stock for $3.50 on or before July 26, 1980); and one Class B Warrant (four of which entitled the holder to purchase one share of common stock for $7.00 on or before December 26, 1980). The offering was to be open for a period of 90 days from December 26, 1979, the effective date of the registration statement. A subscription offer of 2 million of the 10 million units was made to the shareholders of BBB. The proceeds from

the offering and the exercise of the warrants were intended to be used for the construction and operation of a casino hotel in Atlantic City, New Jersey.

Blinder-Robinson was the underwriter for this offering and the underwriting agreement with American Leisure provided for the deposit of all monies collected from subscribers into a special account at Metro National Bank of Denver, Colorado (Metro Bank). It also required the refund of that money and termination of the offer if all of the units were not sold within 90 days from the effective date of the prospectus, or an additional 90 days if extended by mutual agreement between the issuer and the underwriter. The parties did not agree to extend the original deadline of March 25, 1980.

The prospectus made it clear that this offering was for an extremely speculative investment. Not only was American Leisure a new business without an operating history, it was unable to make any immediate use of the proceeds because it had only 1.72 acres of land in Atlantic City and that was insufficient for the development. The prospectus cautioned that American Leisure would have to acquire more land or obtain the necessary variances and approvals to permit the use of its parcel. Accordingly, the prospectus provided that after the closing of the offering, the net proceeds, less deduction of underwriting costs, discounts, commissions and expenses, would be placed in a second escrow account with Metro Bank, as escrow agent, to hold the proceeds for a period not exceeding one year, during which no more than $1 million could be released for certain limited purposes.

Irwin Lampert, an attorney, has had a close personal relationship with Meyer Blinder since they met in Florida in 1972. Mr. Lampert was counsel for Blinder and Blinder-Robinson in an earlier securities case. Mr. Lampert has been president of BBB since its inception in 1976, and Blinder-Robinson did a small underwriting of

one-half million dollars when that company went public. When BBB acquired American Leisure, Irwin Lampert became secretary-treasurer of that company and asked Meyer Blinder to do the underwriting of the securities to obtain the money for the casino hotel development. Meyer Blinder suggested a larger issue than was originally contemplated and recommended the use of warrants to obtain additional funds as the work progressed. He also recommended the employment of Nathan Jacobson as president because of his experience with gambling casinos in Nevada. That was accomplished and Mr. Jacobson, Mr. Lampert and Mr. Blinder met frequently in early 1979 to discuss this project.

The law firm of Friedman and Shaftan, P.C., of New York, New York, was retained as counsel for American Leisure in the offering and the Denver law firm of Brenman, Epstein and Zerobnick, P.C., represented the underwriter. That firm had frequently been counsel for Blinder-Robinson in other underwritings. Because of some difficulties in communicating with the SEC, American Leisure also retained Bernard Feuerstein, a New York lawyer, to assist with the registration. That was pursuant to the recommendation of Meyer Blinder.

The Blinder-Robinson sales force was very enthusiastic about the American Leisure offering. Most of them were quite young (under 30), inexperienced, aggressive and uninhibited. They talked up the American Leisure opportunity with their regular customers before the prospectus became effective and sales were brisk in January and February, 1980. It was common practice for the sales representatives to say that the American Leisure securities would open at a premium in the after-market and some suggested that $5.00 or more could be expected as the opening price. The evidence supports a finding that an established sales practice was to suggest that Blinder-Robinson people had inside information about pending developments which would make the stock increase in

price, and this finding is buttressed by the convenient lapse of memory of sales representatives called as witnesses in this trial.

Much of what the sales representatives said was generated at a sales managers' meeting held in Florida in January, 1980. At that time, Meyer Blinder told the managers that negotiations were proceeding for American Leisure to obtain additional land in Atlantic City and that there would be a public announcement when the deal was made. The managers relayed the same message to the sales representatives who incorporated it in their presentations.

At the time of that meeting, Blinder knew of talks between Irwin Lampert and Joseph Klein, chairman of the board of Cavanagh Communities Corp. (Cavanagh), a company which had a contract to purchase 8.4 acres of land in Atlantic City, near the American Leisure site. Meyer Blinder had participated in those conversations in 1979. After Cavanagh acquired the land, Jacobson talked further with Klein who said there would be an interest in some arrangement if the American Leisure offering succeeded.

In January, 1980, Mr. Jacobson reported to Mr. Klein that the offering was going quite well, and Mr. Klein replied that he couldn't negotiate then because of a pending deal with another company which would or would not be made by February 15. That deal was not made and Lampert then called Klein and said that $19 million of the offering had been sold, but another market-maker was needed for the final $6 million. Joseph Klein recommended Elkins and Co. (Elkins) which agreed to sell $5 million worth of American Leisure units, but then reduced its participation to $2½ million on legal advice that it should not take more than 10% of the issue.

Mr. Sgarlet of Elkins also was involved with Cavanagh and that involvement generated legal concerns for Elkins

if an agreement were to be made between Cavanagh and American Leisure. Accordingly, on March 5, 1980, Mr. Nagy of Elkins called Mr. Padgett, vice-president of Blinder-Robinson, to read a draft of a letter advising purchasers and prospective purchasers of the American Leisure securities that there was no agreement between Cavanagh and American Leisure. Mr. Padgett refused to approve that letter because there was still hope for such an agreement. The result was the withdrawal of Elkins and the cancellation of many of its sales. Other cancellations also were coming through in early March.

It had been expected that the American Leisure offering would be completed and sold out during the week beginning Monday, March 17, 1980. Accordingly, the principal persons involved came to Denver to prepare for a closing during that week.

Recognizing a possibility that the issue would not be sold out, Meyer Blinder had asked Bernard Feuerstein to find out if an underwriter could purchase the securities in a "best efforts, all or nothing" offering, and Mr. Feuerstein called John Della Grotta, a young lawyer at the Washington, D.C. office of the SEC, about March 10, to ask the narrow question of whether there was an absolute restriction or a special rule prohibiting that possibility. Mr. Della Grotta replied that there was none. Mr. Feuerstein advised Mr. Blinder of that answer. Mr. Feuerstein also talked with the National Association of Security [sic] Dealers (NASD) on the same subject and received that same answer with the caveat that there would be concern if the underwriter sold the shares at a premium in the aftermarket.

What had been a possibility soon became a probability during the week of March 17 and there were further discussions by the involved lawyers concerning the purchase of a large block of the securities by Blinder-Robinson. Of particular concern was whether that purchase would

be a material development which should be disclosed by a supplement to the prospectus, commonly called a "sticker." One sticker had already been placed on the prospectus because of a development concerning the subscription offer to the BBB shareholders.

While the evidence is conflicting, the more probable and credible testimony is that Bernard Feuerstein, Gerald Raskin of the Brenman firm, and Mr. Brenman as well, all concluded and advised both Blinder and Padgett that such a sticker would be necessary. When questioned concerning the basis of their advice, both Raskin and Brenman said that it was because the warants imposed a continuing obligation on the issuer to disclose material developments, even after the closing date. That advice, which had been communicated by March 20, 1980, was rejected as a "business decision" by Meyer Blinder and others at Blinder-Robinson. Part of the rationalization for that rejection was that a sticker was seen as futile since more copies of the prospectus would not be delivered, and because it would damage Blinder-Robinson's reputation in the industry if it became known that it could not sell out an offering.

By Wednesday, March 19, 1980, it became apparent that the offering would not be sold out by the deadline of March 25, 1980. Irwin Lampert flew to Miami, Florida, to meet with Joseph Klein and he, in turn, introduced Leon Joseph, a former Cavanagh employee who was the principal of a company called Scope, Inc. (Scope). That company had substantial cash and was negotiating with Klein about the possibility of buying the equity in Perdido Bay Country Club Estates, a real estate development which was in foreclosure. Scope had a good banking relationship with Great American Bank of Dade County, Florida (Great American), and had purchased certificates of deposit from that bank.

On Friday, March 21, 1980, Joseph Klein, his father Zola Klein, and Irwin Lampert met with Leon Joseph

about the possible purchase by Scope of 600,000 American Leisure units. They went to the Great American Bank to negotiate a $1.5 million loan for that purpose. During the discussions, Mr. Klein suggested that Scope could realize a quick profit which could then be used to buy the Perdido Bay property and that he would try to guarantee the loan through Cavanagh. The final agreement was that the loan would be made at an interest rate of 2% more than the bank would pay on a certificate of deposit to be purchased by American Leisure, and Irwin Lampert, on behalf of American Leisure, then agreed that it would buy two certificates of deposit from the Great American Bank; one for $1.5 million at 10% and the other for $1.5 million at 16%, the latter being the market rate at the time. The bank loan to Scope was then made at 12%. It is a fair inference that the loan would not have been made without the agreement for the purchase of the certificates of deposit.

Also on March 21, 1980, a sales representative of Blinder-Robinson assisted his customer, Johan Van Baal, in obtaining a loan of $700,000.00 from Metro Bank for the purpose of assisting in the purchase of 400,000 units of American Leisure. That purchase was effected on March 24, 1980.

The Metro Bank issued Blinder-Robinson a cashier's check, dated March 24, 1980, for $2,371,987.50 for the purchase of the 956,393 units which had not been sold to the public. Those 956,393 units were put in the Blinder-Robinson inventory trading account. The loan was not secured and it was not recorded in the bank's loan records, contrary to the routine business practice of the bank.

On March 25, 1980, the Metro Bank credited Blinder-Robinson for $2,475,000.00, an amount representing the firm's commissions for the sale of 10 million units. Also on March 25, 1980, the bank wired $3,000,000.00 from

the escrow account to the Miami bank for American Leisure to purchase certificates of deposit. Both of these distributions occurred prior to a formal closing of the offering. In fact, no closing ever took place. Most of the closing documents had been executed at the Metro Bank on March 20, 1980, when the offering was far short of completion. By letter of that date, an assistant vice-president of the Metro Bank wrote to the Division of Securities of the State of Colorado and included the following two paragraphs:

> Kindly consider this letter our certification to you that there is on deposit in the above mentioned Escrow Account the aggregate sum of $25,000,000.00 the same being held for the purposes as set forth in the Escrow Agreement.
>
> In view of the foregoing, the Metro National Bank, as Escrow Agent hereby request [sic] authorization from the Colorado Securities Commissioner to release to American Leisure Corp., and/or Blinder, Robinson and Company such funds now on deposit in the Escrow Account, or as may hereafter be deposited into said Escrow Account. (Plaintiff's Exhibit 39P).

At the trial of this matter that bank officer testified that the letter was actually delivered to the Colorado Securities Department on March 24, 1980, during working hours. That certification was false even as of March 24, because the $1,500,000.00 from the Miami bank did not arrive until March 25.

Blinder-Robinson began trading from the inventory of 956,393 American Leisure units with members of the public and other broker-dealers on March 25, 1980. From that date until July 18, 1980, Blinder-Robinson sold 2,209,320 units and purchased 1,828,715 units.

On August 28, 1980, the SEC and Blinder-Robinson orally stipulated that as of that date the firm would

cease trading for its own account in American Leisure securities, and would freeze the firm's holdings in those securities. The stipulation permitted Blinder-Robinson to continue executing unsolicited agency transactions involving American Leisure securities. In a written stipulation filed on April 27, 1981, the Commission and Blinder-Robinson agreed to vacate the earlier stipulation and substituted one which permitted Blinder-Robinson to resume its trading in American Leisure, but continued to require a freeze of the firm's holdings as of August 28, 1980. These stipulations define the continuing after-market distribution as from March 25, 1980 until August 28, 1980, although the evidence before the court traces Blinder-Robinson's after-market trading activity only through July 18, 1980.

SECURITIES ACTS VIOLATIONS

Section 17(a), 10(b), and Rule 10b-5. The SEC alleges that Blinder-Robinson violated Section 17(a) of the 1933 Act, Section 10(b) of the 1934 Act, and Rule 10b-5, by embarking on a fraudulent course of conduct throughout the firm's involvement in the American Leisure offering. The Commission points to alleged fraudulent conduct during Blinder-Robinson's effort to sell the offering, and in connection with the closing of the "all or none" offering. Defendants' position is threefold: 1) that the alleged misrepresentations were not material; 2) that defendants cannot be held responsible for the acts of their salespeople; and 3) that the SEC has failed to establish scienter. Upon consideration of all of the evidence, my conclusion is that Blinder and Blinder-Robinson violated Sections 17(a), 10(b), and Rule 10b-5.

At the outset it is noted that throughout the relevant time period defendants used the mails, telephone and other means of interstate commerce in their various transactions with regard to the American Leisure offering.

Sections 17(a) and 10(b) prohibit the use of manipulative or deceptive device, or scheme or artifice to defraud, in connection with the offer, sale or purchase of any security. Section 17(a)(2) and Rule 10b-5 specifically prohibit the making of any untrue statement of material fact or the omission to state a material fact necessary in order to make the statements made not misleading. A "material fact" is one which a reasonable investor might have considered important in the making of an investment decision. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1972). Actual reliance need not be shown, *id.*, but defendants' scienter must be established for purposes of Rule 10b-5, Section 10(b), and Section 17(a)(1). *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 691, 697 (1980); *Securities and Exchange Commission v. Haswell*, 654 F.2d 698 (10th Cir. 1981).

Meyer Blinder and the Blinder-Robinson sales force aggressively promoted the American Leisure securities before the registration statement became effective and then followed the manipulative and deceptive practice of maintaining market interest by suggesting that the hotel-casino development would be assured because of deals that were being made. The sales presentations followed a pattern of misstatements and omissions. Sales representatives predicted that the American Leisure securities would open at a premium in the aftermarket, without any factual basis for their predictions. They told buyers that the firm's personnel had inside information about developments positively affecting the issuer, when in fact there were no positive developments for the new company during the distribution period.

The cancellations in March came largely as a result of the letter, dated March 10, 1980, from Gabriel Nagy as general counsel of Elkins to its customers, containing the following paragraphs, among others:

> We have been informed that some interest in this offering has been generated in part by the expectation that ALC might invest some or all of the net offering proceeds in a casino project to be developed jointly with Cavanagh Communities Corporation ("CCC"). These two companies own neighboring parcels of land in Atlantic City, New Jersey, and there has been speculation in the public press that they might develop their properties jointly.
>
> Partners and registered representatives of this Firm have substantial investments in CCC, and one of them currently serves as President of CCC.
>
> We have also been informed that ALC and CCC had preliminary, tentative discussions sometime [sic] ago concerning the possibility of a joint development of their properties. However, we are told, no agreements or preliminary understandings resulted from those discussions, those discussions have been terminated and no negotiations or discussions are currently in progress between the two companies.
>
> It is presently contemplated that the ALC offering will not settle before March 19, 1980. As noted above, we are not recommending the purchase of units. As the prospectus notes at page 9, you should understand that you may lose all or part of your investment in the units. If you decide that you do not wish to purchase the units, you may cancel this transaction *without obligation*, by so advising your registered representative by 4:00 P.M. on Thursday, March 13, 1980. (Plaintiff's Exhibit 40K).

Mr. Lampert, for American Leisure, and Mr. Padgett, for Blinder-Robinson, objected to this letter and urged that it not be sent because Mr. Lampert said that negotiations would continue. In my view, Elkins acted appropriately and Blinder-Robinson should have done the same thing. Given the sales practices which had been followed,

the Blinder-Robinson customers buying the American Leisure units should have been given this information and the failure to provide it constitutes a fraudulent practice.

These statements and omissions are directly attributable to Blinder and, through him, to Blinder-Robinson.[1] It is clear that the Blinder-Robinson sales force practiced a program of deliberately deceptive misinformation which Blinder orchestrated. Even if the evidence did not demonstrate his active role, this court would hold Blinder liable for the acts of sales representatives whom he supervised and for whose misconduct he is responsible under Section 20 of the 1934 Act, 15 U.S.C. § 78t (1976). *A.J. White & Co. v. Securities and Exchange Commission*, 556 F.2d 619, 622 (1st Cir. 1977), *cert. denied*, 434 U.S. 969 (1977); *Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc.*, 410 F. Supp. 1002 (S.D.N.Y. 1976), *aff'd. in part and modified in part*, 574 F.2d 90 (2nd Cir. 1978).

Blinder and Blinder-Robinson did not disclose the frantic manipulations which resulted in the pretension that all of the issue had been sold by the March 25 deadline. The investors were not told that $3,000,000.00 of the proceeds of the public offering had been committed to be used as an accommodation for the loan necessary for the Scope purchase with half of that amount invested at 6 points below the market rate. They were not told that the Metro Bank was so anxious to assist its good customer, Blinder-Robinson, that it found it expedient to make a $700,000.00 loan to a person who had no prior banking connection there, and to loan Blinder-Robinson almost the full amount of its commission with the bank

---

[1] "A firm . . . can act only through its agents, and is accountable for the actions of its responsible officers." *A.J. White & Co. v. Securities and Exchange Commission*, 556 F.2d 619, 624 (1st Cir. 1977), *cert. denied*, 434 U.S. 969 (1977). *Accord, Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731, 741 (10th Cir. 1974).

paying itself off from that commission in immediate distribution of the first escrow. They were not told that Blinder-Robinson would, itself, purchase 956,393 units, and place them in inventory to participate in aftermarket transactions.[2]

The misstatements and omissions in this case are material. Information regarding the condition of the issuing company is of great significance to the reasonable investor, particularly where the company is new. *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). Moreover, in an "all or none" offering of securities by a new company, whether all the securities have been sold to the public in bona fide transactions is of particular importance because the "all or none" contingency is the investors' principal protection. Each investor is comforted by the knowledge that unless his judgment to take the risk is shared by enough others to sell out the issue, his money will be returned.

In *A.J. White & Co.*, where one-half of the minimum amount in an "all or none" offering was raised through non-bona fide short term loans, the First Circuit Court of Appeals affirmed the Commission's decision that the purported closing without disclosure of the purchase was a material omission under section 17(a) and 10(b), and Rule 10b-5:

---

[2] The court finds without merit defendants' reasons for not attaching a sticker to the prospectus, despite counsel's advice. Their claim that a sticker would be useless since all the prospectuses were distributed already is not a valid excuse: "If it was too late to disclose the change, the investors had a right to assume that the prospectus would be complied with, not changed." *A.J. White & Co.*, 556 F.2d at 623. Their fear of damage to Blinder-Robinson's business reputation does not excuse their nondisclosure, but simply demonstrates the materiality of the omissions, as discussed *infra* at 14-15.

> Particularly in cases such as this, an offering of shares in a new company, one of the investors' major concerns will be whether the price they are paying for the securities is a fair market price. The inability of the underwriter to sell the specified minimum to bona fide investors may well indicate that the market judges the offering price to be too high. Thus, to declare an offering completed through non-bona fide sales financed through bank loans, where the purported investors have not made an investment decision backed with their own money, may significantly mislead the legitimate investors as to a crucial factor in their decision.

Id., 556 F.2d at 623.

Perhaps most telling in all of the evidence presented at the trial of this case is the testimony of Mr. Padgett that he and Meyer Blinder decided to make a business decision contrary to the advice of their attorneys because to do otherwise would be very damaging to the company's reputation by letting it be known that it could not sell out this offering. That is an admission of materiality.

The requisite scienter for a violation of Sections 17(a)(1), 10(b), and Rule 10b-5, has been defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, n.12 (1976). The courts of appeal are in agreement that reckless behavior satisfies the scienter requirement. *Hackbart v. Holmes*, No. 80-1368 (10th Cir. April 19, 1982) (cases cited in slip op. at 6). In *Hackbart*, the Tenth Circuit adopted the following definition of recklessness: " 'an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.' " *Hackbart*, slip op. at 7 (quoting *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977), *cert. denied*, 434 U.S. 875 (1977).

Defendants' contention that their mental state fell short of the requisite scienter is rejected.[3] The evidence fails to establish a basis in fact for the representations made by Blinder to his sales force regarding American Leisure's prospects for success. Rather, it shows that Blinder knew that the company had no positive developments during the distribution period, and that the offering was meeting with difficulty. The defendants knew that the closing of March 25, 1980 was a pretense. There is no more telling indication of knowledge than the direct receipt of the advice of the involved attorneys to attach a sticker to the prospectus. But despite that knowledge of the materiality of their conduct, and its potential consequences, they ignored counsel's advice. This is not a case of "recklessness"; the defendants acted with a knowing "intent to deceive, manipulate, or defraud" under *Ernst & Ernst*.

Rule 10b-6. The SEC alleges that Blinder and Blinder-Robinson violated Rule 10b-6 when the firm purchased for its trading account 956,393 American Leisure units, continued selling those units to the public, and simultaneously bid for and purchased American Leisure units. Defendants' position is that the firm's purchase of the remaining American Leisure units prior to the specified closing date of the "all or none" offering operated to complete the offering and to remove subsequent activities from the ambit of the rule.

Rule 10b-6 was promulgated by the SEC under Section 10(b) of the 1934 Act, and is designed to prohibit market manipulation by any person participating in the distribution of a security for the duration of that participation. In this case the SEC has established that defend-

---

[3] Of course, Blinder-Robinson is a corporate entity which is not capable of possessing a "mental state." But for purposes of establishing scienter, Blinder's mental state is imputed to Blinder-Robinson. *Securities and Exchange Commission v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1096-97, nn. 16-18 (2nd Cir. 1972).

ants participated in a distribution of American Leisure units, which continued beyond the specified closing date of the offering, and that during their participation defendants bid for and purchased American Leisure units, in manipulation of the market and in violation of Rule 10b-6.[4]

Rule 10b-6 does not define "distribution" as used therein, but in its administrative decisions the SEC has clarified the meaning of the term. In *Gob Shops of America*, Securities Act Release No. 4075 (May 6, 1959), the Commission held that a "major selling effort" would constitute a distribution, and in *Collins Securities Corp.*, Securities Exchange Act Release No. 11766 (October 23, 1975) [1975-76 Transfer Blinder] Fed.Sec.L.Rep. (CCH) ¶ 80,327, *remanded on other grounds*, 562 F.2d 820 (D.C. 1977), the SEC set out the following test:

> Rule 10b-6 . . . is designed to prevent manipulation in the markets. To that end, it precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulative purposes. The term distribution in Rule 10b-6 should therefore be interpreted to identify situations where that temptation may be present.

The Commission also noted that "Rule 10b-6 undoubtedly applies to most registered offerings." *Id.*

It is clear that the American Leisure offering constituted a "distribution." Moreover, that distribution continued beyond March 25, 1980, the date of the purported closing, because the purchases and subsequent

[4] For purposes of Rule 10b-6, the court holds Blinder, as the president and controlling officer of Blinder-Robinson, liable for the firm's misconduct. The evidence presented at trial shows that the firm's purchase of American Leisure units and its subsequent market manipulation was either known to Blinder or at his direction.

sales of American Leisure units by Blinder-Robinson was a continuing after-market distribution of the securities. Rule 10b-6(c)(3) defines an underwriter's participation in a distribution as complete "when he has distributed his participation, including all other securities of the same class acquired in connection with the distribution. . . ." According to the American Leisure prospectus, Blinder-Robinson's participation was the sale of 10 million units "to the public" (less 2 million units which were reserved for sale to BBB shareholders). (Plaintiff's Exhibit 1, at 46-7). With its purchase of 956,393 units, it fell short of completing its distribution by that amount and, consequently, the distribution continued after the purported closing. *R.A. Holman & Co. v. Securities and Exchange Commission*, 366 F.2d 446, 449 (2d Cir. 1966), *modified on other grounds*, 377 F.2d 665 (2d Cir. 1967), *cert. denied*, 389 U.S. 991 (1967); *Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc.*; Whitney, "Rule 10b-6: The Special Study's Rediscovered Rule," 62 *Mich.L.Rev.* 567, 575 (1964). The parties stipulated that Blinder-Robinson would cease trading for its own account in American Leisure units beginning August 28, 1980. The court concludes that the after-market distribution lasted from March 25, 1980 until that date.

The court finds that during the continuing after-market distribution, defendants purchased and sold a large volume of American Leisure units. Those activities constitute the precise types of conduct forbidden by the rule, due to the potential for market manipulation by underwriters who stand to gain from an active market.

Defendants contend that the SEC has not established scienter for purposes of Rule 10b-6. Whether scienter is required under the rule has not been decided by the Supreme Court, and this court is aware of no lower court decision which has considered the issue since the Supreme Court's decisions in *Ernst & Ernst v. Hochfelder*,

and *Aaron v. Securities and Exchange Commission*. It is not necessary to reach that issue in this case, because the evidence reveals that defendants acted with scienter throughout their involvement with the American Leisure offering. This finding certainly applies to defendants' continuation of the distribution by virtue of their purchase of the remaining 956,393 units, and their subsequent purchase of additional American Leisure units.

Rule 10b-9. Under Rule 10b-9 a representation that an offering is on an "all or none" basis constitutes a manipulative or deceptive device prohibited by Section 10(b), unless prompt refunds are made to purchasers if all the securities are not sold at the specified price within the specified time and if the total amount due the seller is not received by it by the specified date. Defendants plainly violated this rule. They underwrote an offering on a "best efforts, all or none" basis; and they failed to promptly refund consideration received from purchasers when, on the specified deadline date, less than all of the securities had been sold, and less than the total proceeds due the seller had been received.

There is no dispute that this was an "all or none" offering, or that Blinder-Robinson failed to refund consideration paid by purchasers of American Leisure units. Defendants' position is that they had no obligation to refund the consideration. They contend that all 10 million units were sold by March 25, 1980; that all the money due the seller was received by that date; and hence, no refund was required.

The SEC has stated that "under Rule 10b-9, an offering may not be considered 'sold' for purposes of the representation 'all or none' unless all the securities required to be placed are sold in *bona fide transactions* and are fully paid for." Securities Exchange Act Release No. 11532 (July 11, 1975), 2 Fed.Sec.L.Rep. (CCH) ¶ 22,730 (emphasis added). The Commission specifically in-

dicated that "sales designed to create the appearance of a successful completion of the offering, such as purchases by the issuer through nominee accounts or purchases by persons whom the issuer has agreed to guarantee against loss," are "non-bona fide sales." *Id.* The court finds that the last-minute transaction through which Blinder-Robinson "sold" almost 2 million units between March 21 and March 24, 1980, were not bona fide sales. *See Securities and Exchange Commission v. Coven*, 581 F.2d 1020, 1028, n.16 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979); *Securities and Exchange Commission v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1095 (2d Cir. 1972).

In addition, the SEC established at trial that the $25 million due American Leisure was not received by the deadline of March 25, 1980. On March 24, 1980, the Metro Bank issued Blinder-Robinson a cashier's check in the amount of $2,371,987.50 for the purchase by the firm of the 956,393 units which had not been sold to the public. Although Blinder-Robinson and the bank called this transaction a "loan," the court is persuaded that it was in fact a distribution of commissions from the proceeds of the offering, prior to its completion. Because this payment occurred prior to March 25, on that date the escrow account was short of the requisite $25 million. Moreover, proceeds received from non-bona fide sales must be considered non-bona fide proceeds which, even though present in the account on March 25, cannot be counted as part of the $25 million specified in the offering prospectus.

Section 15(c) and Rule 15c2-4. Rule 15c2-4, promulgated under Section 15(c) of the 1934 Act, requires the underwriter to establish and maintain an escrow account or separate bank account for all funds received, which funds must remain segregated and untouched until the occurrence of the "all or none" contingency which com-

pletes or vacates the offering. Blinder and Blinder-Robinson established an escrow account at the Metro Bank and it appears that they deposited proceeds from sales into that account as they were received. However, the evidence shows that defendants transferred proceeds from the account prior to the occurrence of the "all or none" contingency on March 25, 1980, and failed to return purchasers' funds upon the occurrence of the contingency. The evidence demonstrates clear violations of Section 15(c) and Rule 15c2-4.

Proceeds were removed from the account, pursuant to defendants' instructions, on at least two occasions. On March 25, 1980, the bank wired $3 million from the escrow account to a Miami bank for use by American Leisure in order to accommodate a loan which the Miami bank agreed to make to Scope. On March 24, 1980, the bank made a purported "loan" to Blinder-Robinson, in which it actually distributed to the firm its commissions from the offering. Withdrawal of those funds prior to the sale of all 10 million American Leisure units was unlawful. *See Securities and Exchange Commission v. Coven*, 581 F.2d at 1028-29 n.17.

In an interpretive release, the SEC has stated that for purposes of Rule 15c2-4:

> If the contingency is "all or none," this requirement means that no funds may be disbursed from the agency or escrow account until all the securities are sold in bona fide transactions and are finally paid for.

Securities Exchange Act of 1934 Release No. 11532 (July 11, 1975). The court has determined that almost 2 million American Leisure units were sold in non-bona fide transactions, *supra*, at 19, which prohibited the completion of the offering and the lawful disbursement of funds from the escrow account to persons other than the purchasers. Yet, defendants failed to return purchasers'

funds promptly after the deadline of March 25, 1980, and have not returned those funds to this day. Instead, having indirectly received their commissions through the Metro Bank "loan," they turned over the remaining funds to the issuer. This is the precise conduct prohibited by Rule 15c2-4. *FAI Investment Analysts, Inc.*, Securities Exchange Act Release No. 14288 (December 19, 1977).

Aider and abettor liability. As a general defense to the violations which occurred during the American Leisure offering, defendants claim that they should not be held liable for the conduct of individual sales representatives. But, Blinder-Robinson is responsible for its employees' actions where those actions were directed by the firm, through Blinder. 15 U.S.C. § 78t (1976). *See* n.1, *supra*, at 12. The liability of Blinder, as president and controlling officer of Blinder-Robinson, is the same as that of the firm. *A.J. White & Co.*, 556 F.2d at 621-22; *Commonwealth Chemical Securities, Inc., supra.*

Defendants have not raised as an issue the extent of their liability as aiders and abettors for conduct of other involved persons, but that issue is relevant where, as in this case, liability under the securities laws is premised in part on contributing conduct by persons not before the court.[5] Specifically, between March 19 and March 25, 1980, Irwin Lampert met with Leon Joseph, Joseph Klein and Zola Klein to negotiate an arrangement whereby Scope would borrow $1.5 million and purchase 600,000 American Leisure units, and American Leisure would accommodate that bank loan by purchasing from the lending bank certificates of deposit in the amount of $3 million. On March 20, 1980, an assistant vice president

---

[5] Defendants' violations of Sections 17(a) and 10(b), and Rules 10b-5 and 10b-6, result solely from their own misconduct. However, the violations of Section 15(c) and Rules 15c2-4 and 10b-9, involve misconduct of the Metro Bank and of the persons who arranged the loan to Scope.

of the Metro Bank wrote to the state securities regulation agency certifying the amount deposited in the escrow account as $25 million; on March 24, the bank made a purported "loan" to Blinder-Robinson which was actually a distribution from the proceeds of the offering; on March 25, the bank wired $3 million from the account for American Leisure to purchase certificates of deposit from the Miami bank; and on March 24 or 26,[6] the bank released the funds from the escrow account to American Leisure.

What is significant is that none of the above activities by third parties occurred in a vacuum. Rather, those activities were either at the direction of Blinder and Blinder-Robinson, or with their full knowledge and tacit approval; and the particular actions taken by the bank and others were simply component parts of the overall scheme which Blinder and Blinder-Robinson orchestrated to give the appearance of completing the offering by March 25, 1980. Under these circumstances, defendants are both directly liable as primary but silent participants, and secondarily liable as aiders and abettors. *Securities and Exchange Commission v. Coven*, 581 F.2d at 1028-29; *Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731, 740 (10th Cir. 1974).

Good faith reliance defense. The defense of good faith reliance on advice of counsel, raised by Blinder-Robinson, is without merit. Although several courts have held that reliance on the advice of counsel can contribute to a general "good faith" defense to certain violations of the securities laws, none has recognized that defense under facts such as are present in this case.

---

[6] The statement for the American Leisure escrow account reflects a debit of $22,130,276.72 on March 26, 1980. (Plaintiff's Exhibit 12f.) But, in a handwritten ledger for that account maintained by the Metro Bank International Department, the payment to American Leisure is shown to have occurred on March 24. (Plaintiff's Exhibit 12g).

Blinder-Robinson contends that prior to purchasing American Leisure units, it sought legal advice as to the propriety of such a purchase. It is undisputed that early in March, 1980, Meyer Blinder, acting for Blinder-Robinson, asked attorney Bernard Feuerstein to find out whether the firm, as the underwriter in a "best efforts, all or none" offering, could purchase the subject securities. In response to Blinder's request, Feuerstein did not render a formal opinion, but simply relayed the information received from a staff attorney at the SEC that there was no absolute restriction or special rule prohibiting an underwriter from purchasing the offered securities in an "all or none" offering. At no time did Blinder inquire as to the legality of other action it took to complete the offering by its deadline of March 25, 1980, and when later advised that a sticker should be placed on the prospectus, disclosing the purchase, Blinder-Robinson declined to follow that advice.

As discussed earlier in this opinion, the evidence supports a finding that Blinder-Robinson acted with scienter in all its violations of the securities laws. This finding of scienter precludes a finding of good faith by the firm with respect to the same actions. *See Securities and Exchange Commission v. Bonastia*, 614 F.2d 908, 914 (3d Cir. 1980) (affirming district court's rejection of defense of good faith reliance on advice of counsel, "in view of the high ranking positions [defendant] held with the various companies engaged in the illegal activity and the specific finding of scienter made by the district court.").

There are additional reasons why the defense fails these defendants. A defendant invoking his reliance on the advice of counsel must establish that he made a complete disclosure to counsel and then followed the advice rendered. *Securities and Exchange Commission v. Savoy Industries, Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981) (*dictum*); *United States v. Hill*, 298 F. Supp. 1221, 1235 (D. Conn. 1969). Blinder did not make a com-

plete disclosure to Feuerstein when he requested advice regarding the purchase of American Leisure units. He indicated the possibility that Blinder-Robinson would buy units, but not that the firm would buy for its trading account and continue to sell the securities to the public after March 25, 1980. He did not disclose the possibility of accommodating loans to sell units to third parties, or that the firm would draw its commissions from the proceeds of the offering, prior to the closing, to purchase the American Leisure units. This information was material to the advice sought, and its omission precludes Blinder-Robinson from claiming reliance on that advice.

The greatest obstacle to Blinder-Robinson's claimed good faith defense is that the firm failed to follow the advice rendered by counsel. By March 20, 1980, Feuerstein and attorneys for Blinder-Robinson had advised Meyer Blinder and Mr. Padgett, vice-president of Blinder-Robinson that a sticker on the prospectus would be necessary to disclose the intended purchase, which the lawyers viewed as a material development. The firm specifically declined to follow that advice, for fear that disclosure of its intent to purchase units would injure its business reputation, and in the belief that no additional prospectuses would be distributed. It is plain that Blinder-Robinson cannot hide now behind legal advice which it chose to ignore. *Securities and Exchange Commission v. Senex Corp.*, 399 F.Supp. 497, 507 (E.D. Ky. 1975), *aff'd.*, 534 F.2d 1240 (6th Cir. 1976).

Upon the foregoing, it is

ORDERED, that the defendants, Blinder-Robinson & Co., Inc. and Meyer Blinder, and their officers, directors, agents, servants, employees, attorneys, successors and assigns, and those persons in active concert or participation with them, and each of them, be and they are hereby permanently enjoined, from directly or indirectly, in connection with the offer to sell, sale, delivery after sale or

purchase of any securities of any issuer whatsoever, including, but not limited to, units (of common stock and warrants), common stock and warrants of American Leisure Corp., through the use of any means or instruments of transportation or communication in interstate commerce, or of the mails:

(1) employing any device, scheme, or artifice to defraud; or

(2) obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(3) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser or upon any person; or

(4) using or employing, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors; or

(5) bidding for or purchasing for any account in which they have a beneficial interest, any security which is the subject of a particular distribution of securities in which they have agreed to participate, or any security of the same class and series, or any right to purchase any such security, or attempting to induce any person to purchase any such security or right, until after they have completed their participation in such distribution; or

(6) making any representation to the effect that any security is being offered or sold on an "all or none" basis unless the security is part of an offering or distribution being made on the condition that all or a specified

amount of the consideration paid for such security will be promptly refunded to the purchaser unless (a) all of the securities being offered are sold at a specified price within a specified time, and (b) the total amount due to the seller is received by him by a specified date; or

(7) making any representation to the effect that any security is being offered or sold on any other basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering or distribution being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless (a) a specified number of units of the security are sold at a specified price within a specified time, and (b) the total amount due to the seller is received by him by a specified date; or

(8) accepting any part of the sale price of any security being distributed unless the money or other consideration received is promptly transmitted to the persons entitled thereto; or

(9) accepting any part of the sale price of any security being distributed unless, if the distribution is being made on an "all or none" basis, or on any other basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs, (a) the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interests therein, until the appropriate event or contingency has occurred, and then the funds are promtly transmitted or returned to the persons entitled thereto, or (b) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit

or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.

Dated: June 8, 1982

BY THE COURT:

/s/ Richard P. Matsch
RICHARD P. MATSCH
Judge
United States District Court

STATE OF COLORADO)
) ss
COUNTY OF ARAPAHOE)

AFFIDAVIT OF MEYER BLINDER

MEYER BLINDER, being duly sworn, deposes and avers as follows:

1. I am Chairman of the Board of Directors, President, Chief Executive Officer and principal shareholder of Blinder, Robinson & Co., Inc., a national securities broker-dealer firm with headquarters offices in Englewood, Colorado. Both I and the Blinder, Robinson firm are defendants in a civil injunctive decree entered by this Court on June 8, 1982 in a civil action captioned *Securities and Exchange Commission v. Blinder, Robinson & Co., Inc., Meyer Blinder, et al. See* 542 F. Supp. 468 (D. Colo. 1982), *aff'd* No. 82-1954, [1983-1984 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 99,491 (10th Cir. Sept. 19, 1983) (unpublished opinion), *cert. denied*, 105 S.Ct. 783 (1985). For related litigation, *see Blinder, Robinson & Co., Inc. and Meyer Blinder v. Securities and Exchange Commission, et al.*, 565 F. Supp. 74 (D. Colo. 1983), *aff'd* 748 F.2d 1415 (10th Cir. 1984), *reh. denied* (Jan. 2, 1985), *cert. denied*, 105 S.Ct. 2655 (1985). I make this Affidavit in support of the Motion to Vacate Injunction filed on behalf of me and the Blinder, Robinson firm. This Affidavit covers the following matters:

	Paragraphs
I. Background of Meyer Blinder	2-8
II. Cumulative Federal And State Administrative Disciplinary Actions Citing The Existing Injunctive Decree As A Ground For Additional Sanctions, And Other Unfair Current Injury to The Firm And Me As A Result of The Injunction	9-11

		Paragraphs
III.	Other Innocent Parties Are Presently Being Harmed By The American Leisure Injunction, And Will Be Further Harmed in The Future if The Injunction Is Not Vacated....	12-13
IV.	Structure And Operations of The Blinder, Robinson Firm	14-29
V.	The "American Leisure" Violations That Form The Predicate For The Underlying Injunction	30-36
VI.	Management Changes At The Blinder, Robinson Firm Since The American Leisure Offering And The Resulting Civil Injunctive Decree	37-48
	A. The Steven Theys-John Cox Management Transition: 1983-1985	38-40
	B. The Hiring of Other Key Personnel	41-46
	C. The Noel Birns-John Cox-Stuart Cohen Present Management Team: 1985-1986..	47-48
VII.	Enormous Firm Investments, In Addition to New Personnel, to Enhance Compliance With Federal And State Securities Laws	49-58
	A. John Cox And The Compliance And Legal Departments	50-51
	B. The Training Center And The Training Programs	52-55
	C. Sophisticated State-of-The-Art Hardware Systems	56-58
VIII.	Blinder, Robinson Underwrites Small Developing Business That Do Not Have Access to Major Capital Markets	59-72
	A. The Firm's Underwriting Activities Generally	60-61

Paragraphs

B. A Conscious Decision to Avoid The Circumstances That Led to The American Leisure Violations 62-63

C. High Underwriting Standards For The Benefit of Shareholders 64-72

IX. Charitable Contributions 73-78

X. Affirmation of Law Compliance 79

I. *Background of Meyer Blinder*

2. I am 64 years old. I grew up in Brooklyn, am married, have three adult children, and have several grandchildren. I worked my way through evening high school in the mid-1930s, was employed in the New York City garment district as a stock and delivery clerk in the late 1930s, and eventually operated my own small remnant business in the New York City garment district in the late 1930s and early 1940s. I am a World War II combat veteran; I was wounded in action six days after D-Day as I fought in the Battle of Saint Lo, France, a couple of days after my infantry unit landed at the Normandy beachhead. After my eventual honorable medical discharge from the U.S. Army, I returned to New York City and resumed my small remnant business in the garment district. Thereafter, I founded a photo supply business, and eventually became involved with my brother in a coffee vending business. In the mid-1950s, my brother and I expanded the vending business from merely 25 machines to over 4,000 machines at various locations throughout New York City. The business expanded into full line vending (foods as well as coffee), and in 1959 my brother and I decided to "go public."

3. In May 1959, my brother and I accomplished a self-underwriting of our full line vending company, Automatic Cafeterias. Neither my brother nor I had prior

experience in the securities industry. We undertook the self-underwriting because we were unable to locate an existing underwriter in the New York City area willing to take a small company public. My brother and I sold our Automatic Cafeterias business in approximately 1962 or 1963, and thereafter I retired from the business world. Prior to 1969, I had never been affiliated with any securities broker-dealer, or with any public company other than Automatic Cafeterias.

4. In approximately 1969, I came out of retirement and organized a small SEC registered broker-dealer firm, Wanderon and Company, located in Jersey City, New Jersey, and specializing in over-the-counter securities. My partners were Tom Wanderon and Mac Robinson. My principal function at the firm was attempting to develop underwritings. In late 1969 or early 1970, Mac Robinson and I sold our interests in Wanderon and Company to Tom Wanderon, and thereafter in May 1970 set up our own brokerage firm, Blinder, Robinson & Company in Westbury, Long Island.

5. At the start, in 1970, the Blinder, Robinson firm was an SEC registered broker-dealer with solely one office. In addition to Mac Robinson and myself, the firm had two other partners, my eldest son (Martin Blinder) and one of his close friends. I handed the development of underwritings, Mac Robinson handled trading, and my son and his friend handled retail sales as well as some trading. The first participated primarily in Regulation A offerings, the average offering being 100,000 shares at $3 per share for total offering proceeds of $300,000. Mac Robinson retired from the firm in approximately 1972, and my eldest son and his friend subsequently left the firm as well. The firm started with approximately $90,000 of capital. During the early 1970s, the firm employed an average of between ten and 20 salesmen at any one time. By November 1976, the firm still had but one office, but had expanded to employ almost 50 salesmen. From 1970 through 1976, the firm

was lead underwriter for only five or six underwritings, participated in a larger number of other distributions as selling group member, and never did as much as $1 million per year in total business. By November 1976, the firm's capital was built up to approximately $400,000 to $500,000.

6. I had a severe heart attack in November 1976, that required me to be hospitalized for approximately a month. Prior to 1977, I had no knowledge about the Denver "penny stock" market. I had assumed that "penny stocks" were associated with Salt Lake City, Utah, and were worthless securities of "shell" corporations with no value. In substance, to me the penny stock market was the bottom of the barrel. In early 1977, while recuperating from my heart attack, I travelled to Denver at the request of a small Denver broker-dealer, Don Douglass, whose firm, Douglass and Company, had severe capital problems. I then became acquainted with the Denver penny stock market and realized it was a legitimate, liquid, live market. The SEC allowed Douglass and Company to accomplish a self-liquidation, rather than seek the appointment of a SIPC trustee, on the condition that I post $50,000 cash in an escrow account. I so provided that $50,000 to assist Douglass and Company to avoid a SIPC receivership proceeding and to assure that all the firm's customers would be made 100 percent whole in the self-liquidation, which they were. In mid-1977 I decided to stay in Denver and redirect the Blinder, Robinson firm into dealing in the Denver penny stock market. I opened and managed the Denver office of Blinder, Robinson, relocated my wife to Denver, and my youngest son, Larry Blinder, took over management of the Westbury, Long Island office of the firm.

7. During the three-year period from 1977 to 1980 Blinder, Robinson gradually became the leader of the penny stock underwriting firms. The firm accomplished from ten to 15 underwritings per year. At first the

underwriting deals averaged in the $500,000 range, and eventually the deals built up to the $3 million range.

8. The activities underlying the present civil injunctive decree involve my role, and the role of various of my subordinates at the firm, in accomplishing an underwriting for American Leisure Corporation during the period from December 1979 through April 1980. The American Leisure Corporation's underwriting was the Blinder, Robinson firm's nineteenth underwriting since the firm's relocation in Denver. Since American Leisure, the firm has successfully completed 54 additional underwritings and six additional mergers of small companies.

II. *Cumulative Federal And State Disciplinary Actions Citing The Existing Injunctive Decree As A Ground For Additional Sanctions, And Other Unfair Current Injury To The Firm And Me As A Result Of The Injunction*

9. Since the imposition by the Court of the injunction against me and the firm in the American Leisure case on June 8, 1982, the Denver SEC Office and eleven states have instituted eleven separate disciplinary actions against the firm and me citing the existence of the injunction as a principal basis for imposing severe disciplinary sanctions against me and the firm, or as a basis for denying the firm registration as a broker-dealer. Each of these disciplinary proceedings is described in detail in the Affidavit of John Cox. The eleven states which have to date commenced proceedings involving the American Leisure injunction include: Alaska, Arizona, California, Hawaii, Iowa, Maine, Massachusetts, Mississippi, Nebraska, North Carolina and Texas.

10. The Denver SEC Office has litigated a major federal SEC administrative disciplinary action against me and the firm based solely upon the American Leisure injunction. After full trial before an SEC Administrative Law Judge, the following administrative disciplinary

sanctions have been recommended by the ALJ to be imposed against me and the firm: (i) suspension of me (Meyer Blinder) from association with any broker or dealer for a period of 90 days (provided, however, the suspension shall not require me (Meyer Blinder) to divest himself of his ownership interest in the Blinder, Robinson firm during the suspension period); (ii) suspension of Blinder, Robinson's registration as a broker-dealer for a period of 45 days (provided, however, that during such suspension period the firm shall nevertheless be allowed to effect unsolicited retail customers' transactions, effect inter-dealer transactions related to such customers' retail transactions, complete outstanding transactions, and make deliveries and transfers of securities; (iii) for two years following the 45-day suspension period, both the firm and I (Meyer Blinder) shall be forbidden to engage in any securities offering, *directly or indirectly*, as underwriter, selling group member, or in any other manner. *See In re Blinder, Robinson & Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 83,911 (Initial Decision of SEC ALJ Markun 1985). The Denver SEC Office requested the ALJ to impose much more severe sanctions against the firm and me, including a bar against my participation in the securities industry, and upon appeal to the SEC is requesting the full Commission to impose against me a much more severe sanction than the ALJ has recommended. Oral argument of the pending appeal before the Commission is scheduled for July 31, 1986.

11. In addition to the pending SEC administrative disciplinary proceeding and the eleven state proceedings noted above, there is an existing threat that other states will attempt to use the existing American Leisure injunctive decree as a basis to revoke or deny broker-dealer registration to Blinder, Robinson. Furthermore, (i) I and the firm are continually barraged with bad publicity and scurrilous remarks about our business reputations result-

ing from the injunctive action, even in connection with our charitable giving; at times, such negative remarks have been made or stimulated by SEC Staff or the staff of state securities commissions (*See* Ex. 1); (ii) the firm has been rejected when it attempted to lease office equipment, despite its excellent financial condition, because of the SEC disciplinary action based upon the American Leisure injunction (*see* Ex. 2); (iii) the firm has lost and continues to lose customers, salesmen, and executives, as a result of the American Leisure injunction and the administrative disciplinary proceedings triggered thereby (*see* Ex. 3); (iv) federal bank regulators have refused to allow me to become a major investor in a federal banking institution as a result of the existing injunction (Ex. 4); (v) the British Government has refused, based primarily on the American Leisure injunction, to grant to me, or to John Cox or other employees or any person associated with me in any capacity a license to operate an investment banking business in Great Britain (*see* Affidavit of John Cox); and (vi) The Nevada Gaming Control Board has to date refused to license me to have an ownership interest in a Nevada casino despite highly favorable personal and business recommendations from such outstanding citizens as Governor Richard Lamm, and District Attorney Norman S. Early, Jr., and Securities Commissioner Royce Griffin (Ex. 5). The principal impediment to my obtaining such a license has been the existence of the American Leisure injunction.

III. *Other Innocent Parties Are Presently Being Harmed By The American Leisure Injunction, And Will Be Further Harmed in The Future If The Injunction Is Not Vacated*

12. The following, among other, classes of other innocent parties are presently being harmed by the American Leisure injunction against the firm and me, and will be further harmed in the future if the injunction is not

vacated: (a) innocent employees and brokers at the firm; (b) companies underwritten or attempting to be underwritten by the firm; (c) shareholders of the companies underwritten by the firm; (d) customers of the firm; and (e) the charities supported by me and the firm.

13. The Blinder, Robinson firm is a national firm doing business in 42 offices located in 16 states. It is licensed to do business in 33 states and the District of Columbia. The firm has over 800 brokers licensed as of March 1, 1986, with another approximately 260 awaiting licensing, and over 175 additional employees. (*See* ¶ 15, *infra*). Of the approximately 1,000 people who earn their principal livelihood at the firm, not more than a handful were involved in the violative conduct underlying the American Leisure injunction. Indeed, of the over 1,000 present officers, employees, and brokers, only approximately 50 of them were affiliated with the firm in early 1980 at the time of the American Leisure offering. None of the firm's customers, the companies the firm has underwritten—or the shareholders thereof, or the charities supported by me and the firm, were involved in the American Leisure violations. If each of the states in which the firm does business may utilize the mere existence of the injunction as a basis to revoke the firm's license or otherwise sanction the firm—as eleven states have already done or are in the process of attempting so to do, and if the SEC may utilize the mere existence of an injunction to suspend the firm's business for substantial time periods and to bar me permanently from the securities business—as the Denver SEC Office is presently attempting so to do, then all of the above classes of innocent parties will be damaged extensively. Employees and brokers will be deprived of their jobs. Customers will be deprived of the services of their brokers, and of investment opportunities in the penny stocks sponsored by the firm. Companies will be deprived of

capital which the firm otherwise would raise for them, and of the stable trading market which the firm provides for their securities. Shareholders of such companies will have an unfair devaluation of their shareholdings. And to the extent that such cumulative state and federal sanctions diminish or deprive me and the firm of the opportunity to lawfully generate income, recipients of the above-noted charitable endeavors will suffer.

IV. *Structure And Operation of The Blinder, Robinson Firm*

14. Blinder, Robinson has 42 offices nationwide, located in 16 states: Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Louisiana, Maryland, Nevada, New Jersey, New Mexico, Missouri, New York, South Carolina, and Utah. The firm is also presently in the process of opening additional offices in some of the states where it already has one or more branch offices.

15. Blinder, Robinson is licensed to do business in 33 states and the District of Columbia: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Missouri, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Utah, Washington, D.C., and Wyoming. It is the policy of the firm eventually to apply for registration in every state in the United States, and we are presently actively pursuing registration in all the remaining states.

16. Blinder, Robinson has grown substantially during the 1979 through 1986 period. A comparison of its 1979, 1980, 1981, and 1982 financial statements (prepared by a small local Denver CPA firm or by other local firms) with its 1983, 1984 and 1985 financial statements (prepared by Laventhal & Horwath, the eleventh largest national accounting and auditing firm) and the firm's audited January 1986 financials demonstrates the following growth:

	July 31, 1979	July 31, 1980	July 31, 1981	July 31, 1982	July 29, 1983
Total Assets	$ 4,988,510	$ 9,053,630	$19,316,700	$16,682,900	$27,766,472
Net Worth	1,350,960	3,779,746	9,545,300	5,850,200	8,916,664
Gross Revenues	6,442,845	15,506,820	37,775,700	17,204,700	41,436,529
Net Income (Loss)	954,427	2,430,086	5,765,500	(4,700,900)	3,066,449
Net Capital	483,277	1,931,769	3,639,500	1,867,400	3,712,771
Excess Net Capital	458,277	1,906,769	3,614,500	1,842,400	3,293,550
Excess Reserve Requirements	1,054,916	1,938,350	3,551,249	2,711,400	6,558,800

	July 27, 1984	July 26, 1985	Six Months Ended January 31, 1986
Total Assets	$13,199,194	$26,554,000	$31,018,100
Net Worth	7,441,677	9,820,000	11,021,300
Gross Revenues	28,479,319	49,283,000	36,172,000*
Net Income (Loss)	(1,129,687)	1,065,000	1,201,500*
Net Capital	3,184,669	5,008,000	4,336,000
Excess Net Capital	3,064,669	4,853,000	4,164,700
Excess Reserve Requirements	1,875,902	2,367,000	5,148,200

* Six months figures (from Aug. 1, 1985 through January 31, 1986)—projected full year figures as of July 31, 1986 would be gross revenues of $65,000,000 and net income of $2,500,000.

17. The Laventhol & Horwarth partner in charge of Blinder, Robinson's annual audit has informed me that, in his expert opinion, based upon Laventhol & Howarth's independent audits of the Blinder, Robinson firm for fiscal years 1983, 1984, 1985 and 1986, he believes the firm is in very good financial condition; has adequate internal financing controls; has strengthened its accounting and financial personnel substantially—particularly in 1984 and thereafter; and has adequate procedures for compliance in the areas of underwritings, customer complaints, sales practices, Blue Sky Laws registration, and financial compliance, including Regulation T and the net capital rule. (*See* Affidavit of Wesley N. Stark, partner, Laventhol & Horwath). Based upon my knowledge of the firm, I concur in these views.

18. In 1980, at the time of the American Leisure offering, Blinder, Robinson had approximately 200 salesmen nationwide, and approximately 50 additional employees. The firm then had approximately 25,000 customer accounts, of which approximately 15,000 were active accounts.

19. In approximately August 1983, several of Blinder, Robinson's principal executives, including C. James Padgett, Stuart Graff, and Charles Trench, led an "exodus" from Blinder, Robinson and set up a competing broker-dealer firm in Denver. (Mr. Padgett had been Blinder, Robinson's executive vice president who supervised the retail sales in the American Leisure offering.) The new firm, Stuart James & Company, pirated approximately 100 to 150 registered representatives, six or seven sales managers, and the Controller from Blinder, Robinson. Marc Geman, legal counsel to me and the Blinder, Robinson firm, who tried the American Leisure injunctive action, resigned as counsel to me and the Blinder, Robinson firm, and joined the competitor firm as a securities principal, *i.e.*, Executive Vice President.

20. As of March 1, 1986, Blinder, Robinson has over 800 registered representatives licensed to do business, including executive-level personnel, and another 260 registered representatives with applications pending. Aside from its registered representatives, the firm has over 175 employees. Out of the 1,000 employees and registered representatives, not more than 50 of them were associated with the firm at the time of the American Leisure offering in 1980. Blinder, Robinson has in excess of 150,000 retail customers, approximately 100,000 of which have active accounts in the sense of consummating at least one transaction, or having some movement of cash or securities in their account, per quarter.

21. From May 1977 (when the firm accomplished its first Denver underwriting) through March 1986, Blinder, Robinson was the underwriter manager or co-manager for 73 new issues in the over-the-counter market that were successfully completed (including the American Leisure issue), as well as an additional six mergers. *See* Exhibit 6. In addition, the firm attempted to underwrite two other offerings which could not be brought to successful completition. In both cases where the underwriting was not successfully completed all proceeds raised were timely returned to the investors. In the 73 successfully completed issues, Blinder, Robinson raised close to $162 million for developing American business.

22. Blinder, Robinson is a market-maker for approximately 96 over-the-counter securities, 33 of which are listed on NASDAQ and 63 of which are traded in the over-the-counter market and quoted in the "pink sheets." These include most of the issues the firm has underwritten as well as certain issues underwritten by Centennial State Securities, a small Colorado broker-dealer firm acquired by Blinder, Robinson in September 1983. Blinder, Robinson focuses on making a market for issues it has underwritten because of (i) the greater knowledge of those companies, and the close and cooperative relation-

ship with its executives that results from the underwriting; and (ii) the need to assure liquidity in these issues for the firm's customers.

23. Blinder, Robinson offers full-line brokerage services to its customers, including stocks for which it does not make a market and those traded on the major exchanges. However, Blinder, Robinson does do the great majority of its business in the market for so-called "penny stocks." Eighty percent of Blinder, Robinson's stock transactions are "penny stock" transactions, assuming that "penny stock" means a stock trading for less than one dollar per share. Blinder, Robinson is the largest firm in the United States that specializes in, and does a majority of its business in, penny stocks.

24. Apart from its underwriting and marketmaking activities the firm also provides its clientele full brokerage services. The firm estimates that it conducted approximately 95% of its 1985 business in over-the-counter stocks. The remaining 5% of the firm's business embraced transactions in listed securities, corporate bonds, municipal securities, government guaranteed securities, options, mutual funds and moneymarket funds; the firm is presently attempting to expand these aspects of its business. The firm estimates it averaged in 1985 approximately 1,000 trades per day at an average amount of approximately $2,000 per trade. The firm executed a total of approximately 240,000 trades in 1985, or approximately $425,000,000 in total trading volume. Similar to other nationally recognized broker-dealer firms, Blinder Robinson has established business relationships with many other broker-dealer firms in the industry. For example, in July 1985, Blinder Robinson was a co-underwriter with Prudential-Bache Securities, Inc. on a $3,025,000 municipal bond offering. The firm introduces its option accounts through Pershing & Co., a division of Donaldson, Lufkin & Jenrette Securities Corporation. The firm also has agreements with Pershing & Co. for NYSE and AMEX access in order to transact listed securities busi-

ness. Moreover, Blinder Robinson has arrangements with the Depository Trust Corporation for the safekeeping of customers' securities and with the National Securities Clearing Corporation for the settlement of securities transaction with other dealers. The firm is a member of both the NASD and SIPC.

25. All except four of Blinder, Robinson's underwritings have been issues offered for $1.00 or less per share. Two offerings were distributed at $1.50 per share (Camelot International at $1.50 per share in June 1977 and Superior Care, Inc. at $1.50 per share in April 1979); Martin Lawrence Limited Editions was distributed at $2.00 per share in December 1984; and the American Leisure Corp. issue in December 1979 was distributed at $2.50 per share. Except for the $25 million American Leisure offering, in none of the firm's other 72 underwritings has the firm ever raised more than $5 million.

26. At the time of the American Leisure offering in late 1979 and early 1980, the Blinder, Robinson firm's principal executives, officers and supervisors were (i) myself, Meyer Blinder; (ii) C. James Padget; (iii) Charles Trench; (iv) Stuart Graff; (v) Larry Blinder; (vi) Harold "Butch" Gorden; and (vii) Harvey Milzer.

27. Since the issuance of the injunction in the American Leisure matter, the Blinder, Robinson firm has been extensively reorganized. The executive, officers, and supervisors during the period 1983 through March 1, 1986 have been:

a. I, *Meyer Blinder*, have been and continue to be President, Chief Executive Officer, and a Director. I exercise overall executive authority over the firm, but do not have overall day-to-day operational responsibilities. I play a major role in the underwriting activities of the firm, and in advising clients on a variety of corporate financial matters, including potential mergers or acquisitions, and alternative methods of financing.

b. From August 1983 to April 1985, *Steven Theys* was Executive Vice President, a member of the board of directors, and *de facto* chief operating officer of the firm. He had overall management and operational responsibilities for the firm beneath me, but concentrated primarily on the areas of corporate finance, underwritings and sales. He resigned from Blinder Robinson in April 1985, to set up his own Denver broker-dealer firm, Royce Park Investments, Inc. Prior to joining Blinder, Robinson, Mr. Theys had been President of Chesley & Dunn, Inc., a small Denver broker-dealer firm. (*See* Affidavit of Steven Theys.) Since his resignation, Mr. Theys' executive and operational duties have been divided among Noel F. Birns, John J. Cox, and Stuart M. Cohen, the firm's three principal vice presidents.

c. *Noel F. Birns* has been a director of Blinder, Robinson since February 1985, and has been Vice President of Administration at the firm since March 1985. Prior to affiliating with the firm, Mr. Birns was President and Director of The Birns Companies located in Palm Springs, California (engaged in business of real estate investments and home furnishings). From 1974 to 1981, Mr. Birns also was Vice President and a director of Sunrise Company in Rancho Mirage, California (engaged in business of real estate development).

d. *John J. Cox* has been a Director of Blinder, Robinson since June 1984, and since March 1984 has been Vice President and Special Assistant to the President, in charge of all legal and compliance matters at the firm, with the authority to overrule all other officers of the firm on any matter involving compliance. Mr. Cox also performs a number of executive and administrative functions previously performed by Steven Theys. From December 1970 to March 1984, Mr. Cox was a high-level national enforcement official of the National Association of Securities Dealers, holding a number of successively more responsible positions in the NASD's New York City

office and in its headquarters office in Washington, D.C. (*See* Affidavit of John J. Cox.)

e. *Stuart M. Cohen* has been National Sales Manager of Blinder, Robinson since April 1985 and also Vice President since January 1986. He began employment at the firm in March 1979 as an account executive, and was successively promoted to the positions respectively of Assistant Branch Manager, Branch Manager, and Regional Manager in charge of the Southeastern Region (consisting of Florida and Georgia). In addition to supervising the firm's national sales force, and the firm's training program, he also supervises the firm's over-the-counter trading activities. (*See* Affidavit of Stuart M. Cohen.)

f. *Regis Dahl* has been Vice President-Corporate Finance of Blinder, Robinson since September 1983. He previously had been a principal of Centennial State Securities, which was acquired by the Blinder, Robinson firm in September 1983. He heads the firm's Corporate Finance Department which, among other activities, handles all of the firm's underwriting efforts.

g. *Larry Blinder*, my youngest son, is Vice President-Operations and a Director of Blinder, Robinson. He has general overall "executive" authority over the operations activities of the firm. His responsibilities have been substantially diminished since 1980 as a result of his Crohn's Disease illness, and the hiring of M. Dean Arkema.

h. *M. Dean Arkema* has been Treasurer, Controller, Financial Principal and a Director of Blinder, Robinson since 1983. He is a certified public accountant and an NASD licensed financial principal. His responsibilities at the firm include the preparation of financial statements, the preparation of financial reports to regulatory agencies, and the supervision of the cage and back office personnel. Mr. Arkema was recommended to the firm by

its independent public accountants, and had previously been employed as the number two person in Hanifen-Imhoff, a regional New York Stock Exchange firm.

i. *H. "Butch" Gorden*, Vice President-Trading, has executive authority over the firm's over-the-counter trading operations. Mr. Gorden's responsibilities have been substantially diminished since 1980 as a result of the hiring of Tony Beshara as the Chief Trader supervising the Trader Department.

28. Apart from myself, my son Larry Blinder, and H. "Butch" Gorden, none of Steven Theys, Noel F. Birns, John J. Cox, M. Dean Arkema, or Regis Dahl was affiliated with the Blinder, Robinson firm at the time of the American Leisure offering, and Stuart M. Cohen, while an employee at the time, did not then serve in any executive capacity.

29. The Blinder, Robinson offices and sales personnel are divided into ten districts, with each district having up to five branches. Each branch office has a Manager and an Assistant Manager supervising registered representatives. District Managers supervise up to five branches each and interface between the branch offices and the headquarters office. Four Assistant National Sales Managers supervise the District Managers and report to the National Sales Manager, Stuart M. Cohen, who is a vice president in the firm's headquarters office. The branch office Manager is responsible for the operations of that office, including supervision of registered representatives and clerical personnel with regard to proper selling techniques, customer complaints, and general administrative functions. It is the policy of the firm that all Managers and Assistant Managers, as well as District and National Sales Managers, are required to be registered as principals with the NASD, that is, they obtain a Series 24 license.

V. *The "American Leisure" Violations That Form The Predicate For The Underlying Injunction*

30. The Court's opinion supporting entry of the underlying injunction against me and the Blinder, Robinson firm is reported at 542 F. Supp. 468 (D. Colo. 1982) (*see* Ex. 7), and the opinion of the Tenth Circuit affirming entry of the injunction is unreported, No. 82-1954, CCH Fed. Sec. L. Rep. ¶ 99,491 (10th Cir. 1983) (*see* Ex. 7).

31. The American Leisure offering underwritten by Blinder, Robinson was a very unusual experience for the firm, indeed, a "one of a kind" occurrence: No other offering underwritten by the firm before or since ever involved total proceeds exceeding $5 million, whereas the American Leisure offering totalled $25 million. Virtually all the firm's underwritings before and since have been "penny stock" underwritings, *i.e.*, $1.00 or less per share or unit, whereas American Leisure was not a "penny stock," it was priced at $2.50 per unit. (Out of the firm's other 72 offerings, only three others were priced above $1.00 per share, one at $2.00 and the other two at $1.50 per share).

32. The American Leisure offering was fully registered with the SEC, and was an "all-or-none" contingent $25 million offering. The purpose of the offering was to provide initial funds for planning, licensing fees, land acquisitions, and initial construction costs of a hotel/casino project in Atlantic City. The American Leisure registration statement became effective, and the offering commenced, on December 26, 1979. During the American Leisure offering in early 1980, C. James Padgett, then Executive Vice President of the firm, supervised the retail sales activities of the firm on a national basis, including supervision of the sales effort regarding the American Leisure distribution.

33. Blinder, Robinson purchased 956,393 American Leisure units in the offering at the public offering price

of $2.50 per unit for a total investment of approximately $2.4 million. The funds invested were my funds and the funds of Blinder, Robinson, including the firm's underwriting commissions earned in the offering. Blinder, Robinson was not a nominee of the issuer, nor did the issuer guarantee Blinder, Robinson against loss. I did not request a formal, written legal opinion from counsel in this regard, and I now feel the failure to do so was a significant mistake by me. Counsel had suggested that it would be prudent to disclose the circumstances of Blinder, Robinson's purchase in a sticker to the prospectus, but Mr. Padgett and I decided not to do so because the 90-day prospectus delivery requirement expired as of the closing. I understood that counsel suggested the sticker as a prudent course of business, but did not understand counsel to advise that the sticker was legally required. (*See* Ex. 9 which consists of excerpts from trial and deposition testimony from the American Leisure injunctive action of many of the counsel involved including Bernard Feuerstein, Albert Brenman, and Robert Shaftan, as well as related testimony on this issue of Mr. Padgett and me, and PX-24a, a March 25, 1980 memorandum to the file by attorney Gerald Raskin.) I now feel that the decision not to sticker the prospectus, and recirculate it to all purchasers, was a significant mistake. I did not intentionally withhold information from counsel, and believed that I was providing them with all the information they requested or needed. (As stated in pargraph 63, *infra*, I have instituted a new procedure at the firm to attempt to assure proper law compliance and effective reliance upon advice of counsel at the firm in similar situations in the future).

34. I joined the Board of Directors of American Leisure Corporation after the public offering to monitor the use of the proceeds of the offering for the purposes represented in the prospectus. The prospectus had noted that American Leisure might be required to spend sub-

stantial sums to acquire sufficient additional land for the hotel/casino project. In April 1980, American Leisure acquired an additional 8.2 acres of land for the project.

35. In May 1984, American Leisure merged with Midland Delaware, Inc., and became American Midland Corporation. The parent company, Midland Resources, Inc., thereafter had a $40 million net worth, and has been actively pursuing the Atlantic City hotel/casino project on a substantially larger scale than the original American Leisure project. I served as a director of American Midland Corporation until January 1985.

36. After the public offering at $2.50 per unit, the American Leisure units traded in the after-market at various times at prices between $4.00 and $5.00 per unit. On July 10, 1984, an investor who had retained his American Leisure units purchased at the public offering price of $2.50 per unit, after their conversion into American Midland securities, and after considering all warrants, dividends, and settlement distributions paid to unit holders who purchased in the public offering, would have had derivative value of approximately $2.32 per unit. (*See* Ex. 10.)

VI. *Management Changes At The Blinder, Robinson Firm Since The American Leisure Offering And The Resulting Civil Injunctive Decree*

37. The management changes at Blinder, Robinson since the American Leisure underwriting in early 1980 and the Court's imposition of a civil injunctive decree in June 1982 are manifest. When the American Leisure offering was sold in early 1980, the seven principal executives of the firm were (i) me (Meyer Blinder), (ii) C. James Padgett, (iii) Charles Trench, (iv) Stuart Graff, (v) Larry Blinder, (vi) Harold "Butch" Gorden, and (vii) Harvey Milzer. Four of these seven are no longer employed at the firm: Messrs. Padgett, Trench, Graff and Milzer. The remaining two apart from me (Larry Blinder and Harold "Butch" Gorden) have had

their responsibilities diminished through the hiring of new executives to handle significant portions of the responsibilities they had in 1980. (The key changes in management personnel and functions from 1980 to 1986 are scheduled in Ex. 11.) Among the changes that have taken place are the following:

a. The replacement of the chief operational officer, C. James Padgett, who had supervised the national retail sales force at the time of the American Leisure offering, by Steven Theys initially (Mr. Padgett left the firm in August 1983, and Mr. Theys served as chief operating officer from August 1983 to April 1985), and presently by a combination of Messers. Birns, Cox and Cohen;

b. The replacement of Charles Trench, the Vice President-Sales at the time of the American Leisure offering, initially by placing sales directly under Mr. Theys and since the departure of Mr. Theys in April 1985, by having Stuart Cohen serve as National Sales Manager;

c. The hiring of John Cox to a new executive position with responsibilites, among others, for compliance, which previously had been a portion of the responsibilities of Mr. Padgett;

d. The hiring of a new Treasurer, Controller and Financial Principal, M. Dean Arkema, to handle responsibilities that previously fell under the aegis of Larry Blinder and Harvey Milzer;

e. The hiring of a new Compliance Department Manager, Rick Hartness, and new in-house lawyers, including Timothy O'Conner, to handle legal responsibilities that previously had been taken care of by the former head of the Compliance Department;

f. The hiring of a new Cage Manager, Joe Zingalli;

g. The creation of a Training Center and the new position of Training Director devoted full-time to training new registered representatives; and

h. The strengthening of the underwriting and corporate finance department by adding Regis Dahl, who had previously been a principal of Centennial State Securities, as Vice President-Corporate Finance.

A. *The Steven Theys-John Cox Management Transition: 1983-1985*

38. Steven Theys was hired as the firms's new Executive Vice President in August 1983. Prior thereto he had been President of Chesley & Dunn, another Denver broker-dealer firm, where he had overall responsibility for the management and supervision of the firm. From August 1983 until April 1985, Mr. Theys had overall management and operational responsibility for the Blinder, Robinson firm, under me. I was the Chief Executive Officer, and he was *de facto* the chief operating officer. Mr. Theys concentrated his operational activities in the areas of corporate finance, including underwritings, and sales.

39. John Cox was hired in March 1984 to fill the newly created positions of Vice President-Compliance and Special Assistant to the President. He has been given new and unique authority over the firm's compliance with federal and state securities laws, including authority to overrule all other persons in the firm, including me (Meyer Blinder). He has been given absolute authority over the termination of registered representatives, and has used that authority in dismissing registered representatives who have violated legal and compliance rules, regulations and procedures. The terms of Mr. Cox's employment were specifically molded to assure that he could not be pressured into compromising on any of the compliance matters placed within his control.

40. Mr. Cox's background made him uniquely and extraordinarily qualified to fulfill the compliance role created for him. Before joining the firm he had been employed at the NASD for 14 years. After starting as

an Examiner Trainee, he had been promoted regularly to positions as Examiner, Supervisor of Examiners, Supervisor of the Antifraud Section, head of investigations and terminations for cause, Assistant Director of the Reguatory Policy and Procedures Department, and Director of Internal Review. In these positions, he had hands-on experience as an examiner and investigator, he trained other personnel, he issued interpretive letters on difficult areas of broker-dealer compliance, and he drafted examining procedures. While at the NASD he served on a number of special investigative Task Forces together with state and federal regulatory officials, including an NASD/SEC Salt Lake City Task Force, an NASD/SEC Los Angeles Task Force, and NASD/State of Minnesota Task Force, and an NASD Task Force for broker-dealer financial problems in Denver. It was after Mr. Cox participated in an NASD investigation of the Blinder, Robinson firm, and in a regulatory action against the firm by the SEC (in which Mr. Cox twice testified as the SEC's principal expert witness), that I determined to seek to hire him to fill a new position at the firm in which he could use his expertise to help assure Blinder, Robinson's future compliance with state and federal securities laws. Indeed, District Judge John Kane who handled the SEC regulatory action against the firm, recognized Mr. Cox as "one of the foremost experts in the country on compliance and NASD rules." One of the principal reasons I hired John Cox, and created the special executive position he holds at the firm, was to assure that neither I nor the firm would ever again make the mistakes we made in the American Leisure offering which led to the Court's imposition of a civil injunctive decree against me and the firm.

B. *The Hiring of Other Key Personnel*

41. M. Dean Arkema was hired by the firm in 1983 to serve as Controller and Financial Principal. He is also Treasurer of Blinder, Robinson. He was recommended to

me by Laventhal & Howarth, the firm's independent certified public accountants, and had previously been employed as the number two person in Hanifen-Imhoff, a regional New York Stock Exchange firm. I chose Mr. Arkema for the job, which encompasses many of the responsibilities previously performed by my son Larry Blinder, because of his ten years of experience at Hanifen, and because he is both a certified public accountant and an NASD licensed financial principal. Mr. Arkema serves as a member of the firm's board of directors. His responsibilities include the preparation of financial statements, the preparation of financial reports to regulatory agencies, and the supervision of the cage and back office personnel. One of the principal reasons I hired M. Dean Arkema was to assure that the firm avoided any legal or regulatory compliance problems in its bookkeeping, back office, and financial responsibility activities.

42. I hired Joseph Zingalli in 1983 to be Cage Manager of the firm. He had been with a private Wall Street consulting firm, Mannle & Co., that the firm retained to resolve books and records problems caused by an extensive back office computer conversion effort. These back office problems form the basis for the regulatory action the SEC is litigating against the firm before District Judge John Kane. Mr. Zingalli's job encompasses many of the responsibilities previously performed by my son Larry Blinder. One of the principal reasons I hired Mr. Zingalli as Cage Manager was to assure that the firm avoided any legal or regulatory compliance problems in its bookkeeping, back office and cage operations.

43. At the insistence of Mr. Cox, Rick Hartness was hired in 1984 as the new Manager of the Compliance Department. Mr. Hartness had previously been employed as an examiner for the NASD with an excellent reputation in both Denver and Washington, D.C., and was recruited from another Denver firm.

44. I hired Timothy O'Connor in 1983 as an in-house legal counsel principally responsible for assuring that all aspects of the firm's underwriting activities comply fully with all laws, rules and regulations. Mr. O'Connor was previously in private practice as a securities lawyer with a Denver law firm. (*See* Affidavit of Timothy J. O'Connor.) One of the principal reasons I hired Timothy O'Connor as in-house legal counsel was to assure that the firm avoided any legal or regulatory compliance problems in its underwriting activities of the nature encountered in the American Leisure offering.

45. Regis Dahl joined the firm as Vice President-Corporate Finance in September 1983 as a consequence of the acquisition of Centennial State Securities. Mr. Dahl is one of the firm's principal executive officers engaged in the development and conduct of Blinder, Robinson's underwriting activities.

46. In early 1980, at the time of the American Leisure offering, the members of the Board of Directors of the firm were: me (Meyer Blinder), Larry Blinder, C. James Padgett, Harold "Butch" Gorden, and Larry Kaplan. Since that time, the Board has been expanded and revamped. The Board's present members in 1986 are: me (Meyer Blinder), John Cox, Noel F. Birns, Larry Blinder, Harold "Butch" Gorden and M. Dean Arkema. Steve Theys was also a Board member from August 1983 through April 1985.

C. *The Noel Birns-John Cox-Stuart Cohen Present Management Team: 1985-1986*

47. When Steven Theys left the firm in April 1985 to set up his own broker-dealer firm, I decided that the firm had made such significant strides under the Theys-Cox operational leadership team that it was more appropriate to increase the executive authority of John Cox and other officers, rather than to fill the Executive Vice President slot retaining all the authority previously vested

in Mr. Theys. Noel Birns, who had previously been hired in February 1985 as a Vice President, assumed responsibility for the principal administrative operational functions previously performed by Mr. Theys. He is also a Director of the firm. In addition to his legal and compliance responsibilities, Mr. Cox assumed supervisory responsibility previously performed by Mr. Theys over the following departments or areas: (i) municipal bond trading, (ii) research, and (iii) corporate finance. Stuart Cohen was appointed National Sales Manager in April 1985 and was named vice president in February 1986. He performs the executive oversight of the national sales staff previously performed by Mr. Theys. In addition, he has assumed the supervisory responsibility, previously performed by Mr. Theys, over the firm's training and over-the-counter trading activities.

48. I believe the present Noel Birns-John Cox-Stuart Cohen management team, operating under my general executive direction, supported by the cadre of middle level managerial personnel brought to the firm in the 1983-1984 period, and implementing the revised procedures and policies installed at the firm in the same period, demonstrates an "attitude of excellence," and has a strong commitment to assure the firm operates lawfully in the best interests of its many thousands of public customers.

VII. *Enormous Firm Investments, In Addition to New Personnel, to Enhance Compliance With Federal And State Securities Laws*

49. Since the problems experienced by me and the firm in the American Leisure offering in early 1980, in addition to increased personnel costs across-the-board, the investments made by Blinder, Robinson in its compliance programs—in terms of increased costs and expanded personnel—have been extraordinary. These include (a) the creation of a new position for Mr. Cox; (b) the enhance-

ment of the compliance and law functions within the organization; (c) the development of a Training Center and the institution of a three-week training program for all new registered representatives; (d) the conduct of quarterly meetings of Managers and Assistant Managers in the headquarters office; (e) the installation of an extensive system of computer controls against violations; and (f) the installation of a costly new telephone control system.

A. *John Cox And The Compliance And Legal Departments*

50. The position now occupied by John Cox did not exist at the time of the American Leisure underwriting. This represents a major investment in executive compensation solely for the purpose of enhancing the firm's compliance program.

51. Blinder, Robinson now has two independent departments dealing with compliance and legal matters, respectively. At the time of the American Leisure underwriting, one person handled both responsibilities. The Legal Department, headed by Timothy O'Connor, now includes two lawyers, one paralegal, and three secrataries/legal assistants. The Compliance Department, headed by Rick Hartness, now includes the manager, two registration personnel, and three customer service personnel. Both Departments report to John Cox, as set forth in more detail in the Affidavit of John Cox.

B. *The Training Center And The Training Programs*

52. In 1984, Blinder, Robinson developed an extensive Training Center and instituted at its headquarters office a three-week training program for all of its registered representatives nationwide. The program was designed and implemented to be the best in the industry, including "Big Board" brokerage firms. The training program covers all activities of the registered representatives, in-

cluding a wide range of compliance matters, the execution of trades, and the internal functions of the various departments within the Blinder,Robinson organization.

53. The training program functions in substantial part as a compliance program. Trainees are taught proper sales techniques, the "know-your-customer" rule, suitability rules, rules against unauthorized transactions, Blue Sky compliance, Regulation T compliance, rules against "free-riding" by underwriters, and general rules of fair practice as a broker-dealer. Both Mr. Cox and Mr. Hartness address the trainees on these compliance matters during the course of the three-week program. Mr. Cox himself reviewed and approved the Training Reference Manual used during these sessions.

54. The training program is unusual for a penny stock oriented broker-dealer. Penny stock firms are traditionally poorly capitalized and therefore unable to afford a program of this nature. The costs of the firm's training program are substantial. Initial costs for the physical training facility in the firm's headquarters office were approximately $150,000. The monthly cost of running the program, including transportation and housing for registered representatives and other ongoing expenses, is in excess of $100,000 per month. Thus, Blinder, Robinson speeds well in excess of $1 million per year in its training program.

55. One of the principal reasons that I instituted and funded the training program, and continue to do so, is to attempt to avoid sales practice violations by registered representatives and their supervisors at the firm of the nature that occurred in connection with underwriting sales and after-market sales of American Leisure securities.

C. *Sophisticated State-of-The-Art Hardware Systems*

56. Blinder, Robinson has installed a state-of-the-art computer system at a cost of over $3 million that is di-

rected, in part, towards preventing blue sky violations in the various states; *i.e.*, to assure that no sales are made in any state unless the firm, the registered representative, and the particular securities issue are properly registered or qualified, or properly exempt from registration or qualification, before any sales are made in a particular state. The computer system is more particularly described in the Affidavit of John Cox.

57. Blinder, Robinson also has installed in its headquarters office, and in most of its field offices, a computer-operated telephone system that requires each registered representative to enter a code in order to make a long distance call and prevents any outgoing calls to states in which that person is not registered. This phone system is also set to prevent calls to any state in which the firm is not registered or the stock is not blue-skyed. It is a very expensive system which the firm is in the process of installing in every one of its offices throughout the country.

58. One of the principal reasons that I instituted and funded the state of the art computer system and the computer-operated telephone system, and continue to maintain them, is to assure full compliance with all state blue sky laws in connection with the firm's extensive sales activities.

VIII. *Blinder, Robinson Underwriters Small Developing Businesses That Do Not Have Access to Major Capital Markets*

59. Blinder, Robinson's underwriting activities are directed toward a market that otherwise has difficulties obtaining financing. The firm focuses its underwriting activities on small growth companies with the potential for dramatic increases in sales, or for the development of new, innovative products. These companies often have difficulties finding underwriters in traditional money cen-

ters like New York, and therefore come to the Denver penny stock marketplace as a source of equity financing not generally available elsewhere.

A. *The Firm's Underwriting Activities Generally*

60. Virtually all of Blinder, Robinson's underwritings involve initial public offerings of start-up companies in the penny stock market. In the vernacular, we "incubate baby companies." We try to help the "small man" who is an entrepreneur with an idea or a product, but who has no place to go to raise the capital he needs to finance a successful business. Absent special circumstances, Blinder, Robinson does not do secondary offerings of companies that have already been public.

61. Ex. 6 contains a listing of all of the underwritings done by the firm to date. Following is a short description of a few of them:

a. *Mammatech Corp.*—$3 million—Mammatech has devised a method for early detection of breast cancer. Mammatech owns a patented breast tumor detection training system which provides women with a realistic and effective method for performing breast self-examination. Mammatech also plans to complete the development of a computer-based system for use in training women in the self-examination. Mammatech's patented system can detect over 90 percent of all cancerous breast tumors, reduce the ordeal of radical mastectomy, and help save countless lives each year. (*See* Affidavit of Dr. Mark Kane Goldstein).

b. *American Television and Satellite, Inc.* (now doing business as American Communications & Television—$5 million—American Communications & Television ("ACT") is a highly diversified company in the telecommunications industry. ACT operates television stations in the south, southwest and other areas. It also provides SMATV services in South and West Florida

and cable T.V. services in North and Central Florida. ACT also operates two separate "mobile uplinks" that transmit television signals through orbiting satellites. It also operates a mobile radio telephone system in several Florida cities, and has an 11.8% interest in Quotrader Corp. which has developed an on-line commodity market quotation system. (*See* Affidavit of Dr. Mark Kane Goldstein).

c. *Hi-Tech Robotics, Ltd.*—$3 million—With Japan as a model, American industry has recently recognized the significance of robotics to the efficiency of mass production. Hi-Tech Robotics designs robotics systems for companies that have determined to introduce robotics to their manufacturing process. The company analyses a customer's specifications, designs or re-designs a robotics system, and tests, installs, and services the system. By designing systems, rather than producing the actual robots, Hi-Tech Robotics has insulated itself from the inevitable obsolescence of robot and carried out an important role in industrial production. (*See also* Affidavit of Paul Caruso).

d. *American Strategic Metals*—$1.6 million—American Strategic Metals ("ASM") recovers "strategic metals" from specialized scrap materials. Strategic metals are metals critical to the nation's economy and defense and are not found in sufficient quantities on domestic lands to meet demand. ASM focuses its recovery activities on metals that have primary applications in the defense, aerospace, electronic and other high technology, carbide cutting tool, and rock drilling bit industries. ASM's recovery process converts scrap carbides into powders. The powders are then sold directly to various industrial users. The costs associated with this reclamation method are lower than the costs of newly-mined materials.

e. *TouchStone Software*—$1.5 million—Touchstone Software designs, develops, markets, and supports a line

of computer software programs that provide compatibility between different types of computers. Licensed end-users of TouchStone's products include government agencies, utilities, educational institutions, software development companies, manufacturers, and others.

f. *SPM Group, Inc.*—$3 million—SPM has devised a method for significantly reducing emissions from the process of waste disposal. In contrast to methods involving the mass burning of municipal solid waste, SPM developed a patented process for resource recovery that converts solid waste into high grade fuel, recycleable paper, and usable compost rather than toxic emissions. SPM has also entered the promising field of methane gas recovery from old landfills.

g. *Gateway Communications*—$1.5 million—Gateway is engaged in the design, development, manufacture and sale of micro-processor-based, general purpose communications network systems, including hardware and software, for use in office, manufacturing and educational environments. Since January 1982, Gateway has concentrated on developing and networking products for use with IBM PC and IBM PC-compatible microcomputers. Gateway's goal is to design, develop, manufacture and sell low cost, easy to use, flexible and reliable communications systems providing local and remote networking that are easy to install, maintain and reconfigure, and are sufficiently expandable to accommodate growth and changes in a user's requirements.

h. *Telstar Corp.*—$3 million—Telstar is one of the nation's largest providers of satellite programming to the lodging industry. Telstar also includes Country Music Television, a 24-hour cable network featuring top country music videos. In 1985, Telstar was ranked 29th in the Inc. Magazine annual survey of the 100 fastest growing companies with sales under $25 million. (*See* "The 1985 Inc. 100," Inc. Magazine, May 1985, at 57.)

i. *Western Energy Development Company, Inc.* ("WEDCO")—$3 million—WEDCO engages in drilling for oil and gas, purchase and operation of producing wells, acquisition and sale of oil and gas properties, marketing of income and drilling limited partnerships, and consulting to the oil and gas industry.

j. *CompuSonics Corporation*—$1.5 million—CompuSonics has developed a revolutionary digital audio system, which may replace the conventional (analog) recording systems. While conventional systems are subject to noise, wear, and the inherent background output of the record or tape, advances in computer technology have led to the development of digital recording and playback systems, which are virtually immune from distortion, error, and degradation over time. CompuSonics has developed a unique system for recording audio signals to permit the best possible reproduction of the original signal. (CompuSonics' developments are reviewed in "Technology: The Search For the Digital Recorder," Fortune Magazine (Nov. 12, 1984), at 116.).

k. *Pasta Via International, Inc.*—$1.5 million—Pasta Via operates retail stores in Colorado that feature fresh pasta, sauces, salads and other products. It also operates a Commissary that prepares most of the products sold in the Company's stores.

l. *Envirosure Management Corp.*—$2.5 million—Envirosure is a Buffalo, New York company conducting a hazardous and non-hazardous waste management business serving primarily agencies of the U.S. government and commercial industrial companies. The Company enters into contracts with waste producers to provide integrated waste management services including evaluation, collection, transportation, processing, treatment, and incineration or disposal of hazardous and non-hazardous wastes. (*See* Affidavit of Norman R. Dobiesz).

B. *A Conscious Decision to Avoid The Circumstances That Led to The American Leisure Violations*

62. As a result of the harm caused by, and the damages suffered from, the American Leisure injunctive action, and because of compliance difficulties inherent in contingent underwritings generally, Blinder, Robinson has made a firm policy decision to avoid contingent underwritings in the future whenever possible. The firm has successfully completed 54 underwritings since the American Leisure offering in early 1980.

63. In order to avoid a repeat of the mistakes made in the American Leisure underwriting (*i.e.*, where I thought counsel had approved the firm's purchase to close the contingent offering, but where the Court rejected my reliance upon advice of counsel defense), I have instituted a procedure at the firm where we now require a *written* legal opinion from outside counsel, as well as a legal opinion from our in-house counsel Tim O'Conner, in connection with any problems arising in an underwriting. That this new procedure works is demonstrated by its implementation in a proposed underwriting of Telephone Express Corp. in 1984. (*See* Affidavit of Timothy J. O'Connor.)

C. *High Underwriting Standards For The Benefit of Shareholders*

64. Blinder, Robinson sets especially demanding standards for its underwritings in order to protect the interests of the public shareholders. These special requirements, which are goals that are not always attainable in every respect in each issue, address, among others, the following four areas of possible abuse by the insiders: (a) the percentage of the company offered to the public; (b) quick profits to insiders on the sale of their shares; (c) net worth of the issuer; and (d) diversion of proceeds from the offering for the repayment of loans to insiders. (*See* Affidavit of Timothy J. O'Connor.)

65. Blinder, Robinson believes that if public shareholders are going to take substantial risks providing capital for budding ventures, they must be given an opportunity to own a significant portion of the company. Accordingly, absent a compelling exception, the firm will not underwrite an offering that generally provides less than 30 percent of the shares to the public. In most offerings, 40 to 50 percent of the shares are sold to the public. In 1984 and 1985, due to special circumstances, the firm did underwrite offerings in which one issuer offered only 10 percent, and three issuers offered respectfully approximately 20 percent, of their equity securities to the public.

66. Blinder, Robinson believes that insiders and promoters of new ventures should not be able to score a quick profit on a new issue, and thereby reduce their commitment to the growth and success of the company. For this reason, a prerequisite for any underwriting done by the firm is that the inside shareholders and promoters sign a restrictive agreement precluding the resale of their shares for a significant period of time, usually a three-year period, following the effective date of the offering. Twice in 1984 the firm accepted an 18-month period, and the firm accepted a 24-month period, once in 1984 and once in 1985. Also, in one underwriting in 1984 there was not stated period. This self-imposed standard exceeds the requirements of Rule 144 directed to this purpose, and is more restrictive than the general practice among underwriters.

67. Blinder, Robinson believes it is important that a new issuer have value to support the equity financing provided through the underwriting. It therefore has a net worth requirement for issuers on a sliding scale depending on the size of the underwriting. Thus, an offering of $1.5 million would generally have a $250,000 to $300,000 net worth requirement, while a $3 million offering would generally require $500,000 minimum net worth.

Seldom does the first accept net worth less than 10 percent, and has only done so on rare occasions, justified by an issuer's revenue history, length of time in the business, offering size, and significant current shareholder dollar investment. This net worth requirement has the effect of reducing monetary dilution to the shareholders by raising the book value per share.

68. Blinder, Robinson believes that the proceeds of an underwriting should be used to further develop the potential of the company. Whenever possible, it therefore specifically precludes the use of proceeds to retire debt previously generated by the promoters of the company, including the repayment of loans to insiders. A more detailed list of the firm's current underwriting standards is contained in the Affidavit of Timothy J. O'Connor.

69. According to an analysis done by Fortune Magazine, in 1983 Blinder, Robinson ranked second of all underwriters of more than ten issues in terms of the performance of those new issues in the market after the offering was completed. This placed Blinder, Robinson well ahead of even the most prestigious Wall Street underwriting firms like Merril Lynch and Prudential-Bache. *See* Ex 12.

70. In an anlysis done by Forbes Magazine in 1986, all investment bankers who completed five or more "initial public offerings" in 1985 were ranked based upon the percentage of each investment banker's initial public offerings that outperformed the Standard & Poor's 500. Blinder, Robinson was credited with six 1985 initial public offerings. Five of them (83 percent) had gains at year-end, and two of them (33 percent) outperformed the Standard & Poor's 500. The Forbes report ranks Blinder, Robinson thirty-first, just behind the prestigous Wall Street firms of Prudential-Bache (26), Lazard Freres (29) and Goldman Sachs & Co. (30). Blinder, Robinson ranked ahead of such recognized national firms

as Wheat First Securities (32) and Kidder Peabody & Co. (33). (*See* Ex. 13, Forbes, March 10, 1986, at 122). The Forbes article reports that the six issues underwritten by Blinder, Robinson experienced a 27 percent actual gain as a whole, and an eight percent gain relative to the Standard & Poor's 500. The article further reports that 10 percent of all Blinder, Robinson issues from 1975 through 1984 outperformed the Standard & Poor's 500.

71. The underwritings accomplished by Blinder, Robinson, as well as underwritings generally of initial public offerings in the "penny stock market," perform in the aftermarket in a manner that compares favorably with other market segments. This has been established in a February 1985 "Special Report" published by "Going Public—Thte IPO Reporter" entitled "The Aftermarket of 1984 Initial Public Offerings." *See* Ex. 14 (the Special Report, and a summary of excerpts therefrom that relate to Blinder, Robinson).

72. Blinder, Robinson serves most of the companies whose securities it has underwritten as a continuing resource after the offering has been completed. The firm remains in constant contact with these companies, and renders continuing investment banking and corporate finance advice to them on a variety of ongoing needs, including, for example, potential mergers and acquisitions, the need for additional funding, and the like.

IX. *Charitable Contributions*

73. Blinder, Robinson has a formal charitable fundraising department in which four employees devote a substantial part of their time developing, promoting and administering fundraising activities for several charitable organizations sponsored by me and the firm.

74. The firm and I are the principal supporters of the Blinder Center for Crohn's Disease Research at UCLA

Medical School, contributing approximately $120,000 per year to fund salary and research support for several young medical research investigators. The charitable entity is called the Blinder Research Foundation for Crohn's Disease. The firm and I have also pledged an additional $1 million (and already paid $200,000 thereof) to fund construction of a facility for an International Crohn's Disease Research Center at UCLA. The Center will be titled The Blinder Center for Crohn's Disease Research. These funds are derived from the firm's efforts to raise charitable contributions (a) from its salesmen and employees, primarily at the firm's annual convention, all of which contributions are matched by personal contributions by my wife and me; and (b) from the proceeds of a golf tournament co-sponsored each year by the firm, the Blinder Foundation, and the Governor of Colorado, which proceeds are also matched by my wife and me. (*See* Affidavit of Dr. Gary L. Gitnick; *see also* Ex. 15.)

75. The firm and I are major contributors to Children's Hospital in Denver. The firm has paid over $250,000 to the hospital to fund a new emergency room called The Blinder Robinson Emergency Center at Children's Hospital. The firm has sponsored a basketball game and wine and cheese tasting parties as fundraisers for Children's Hospital. As with the Crohn's Disease Foundation, the firm matches all charitable gifts its employees and salesman give to Children's Hospital. *See* Affidavit of Stuart C. Turgel.) The firm also pays all the expenses of these Children's Hospital fundraisers. (*See also* Ex. 16.)

76. Among various other charities, the firm and I are substantial contributors to the Yeshiva Chaim Torris, an international school based in Denver for underprivileged children around the world. The firm and I have contributed over $75,000 to the Yeshiva.

77. Apart from Crohn's Disease research, most of the charities supported by the firm and me relate to children.

My theory is that the children are the backbone of this Nation and through them this Country will grow.

78. Starting in Christmas 1985, the firm commenced a new, annual Christmas charity program whereby 25 cities throughout the United States in which Blinder, Robinson has offices, the firm at its own expense distributed 8,687 free Christmas Dinner packages feeding over 40,000 needy people. In addition to the firm expending directly approximately $106,000, and the firm's employees donating an additional approximately $45,000, to finance this effort, firm personnel in many of the cities volunteered time and efforts to package and distribute the foodstuffs. This program will be continued annually and will be expanded to cover more needy families. *See* Ex. 17.)

X. *Affirmation of Law Compliance*

79. I respectfully represent to the Court that throughout my activities in the Blinder, Robinson firm I shall attempt to the best of my abiilty to obey the federal securities laws and the rules and regulations thereunder, and to cause all officers and employees of the firm to do the same. In this connection, I respectfully represent to the Court that I shall not overrule John Cox in any legal or compliance decision he shall make at the firm.

FURTHER AFFIANT SAYETH NOT.

/s/ Meyer Blinder
MEYER BLINDER

Subscribed and sworn to before me this 2nd day of May, 1986.

/s/ Nora Peterson
Notary Public

My Commission expires:
9-21-86

U.S. House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
Room 2125, Rayburn House Office Building
Washington, D.C. 20515

SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS

February 10, 1987

The Honorable John S. R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives and our continuing oversight of the Nation's securities markets, the Subcommittee requests updated information on the status of the Commission's investigation in the matter of transactions in Washington Public Power Supply System (WPPSS) bonds in connection with the summer 1983 default of WPPSS on interest payments due on $2.25 billion in outstanding bonds.

Recent complaints to the Subcommittee and press reports—"Draft of SEC Report on WPPSS Default May Be Released Within Next 60 Days," *Bond Buyer*, Tuesday, December 9, 1986; "SEC Staff Meeting With The Lawyers For Various Targets of WPPSS Inquiry," *Bond Buyer*, Tuesday, January 20, 1987—have raised concerns that the Commission may not pursue enforcement action against members of the investment community (Wall Street Underwriters, financial advisers, dealers, their trading department and unit investment trusts, issuers, rating firms, bond counsel) but instead merely will issue administrative reports on the Commission's investigation.

If true, serious concerns are raised about the ability and willingness of the Commission vigorously to enforce the federal securities laws for the protection of investors. Available data suggests that, as a disruption of the municipal bond market, the WPPSS default is unmatched by any event since the Great Depression. The effect on investors to whom WPPSS bonds were retailed was in many cases devastating.

Serious questions have been raised, for example, about the misrepresentations and omissions in the so-called Official Statements prepared by WPPSS before each of the bond sales, the credit analyses prepared by John Nuveen & Co. in 1979 and the early 1980s, and similar reports prepared by Smith Barney, Blyth Eastman, and others.

Merrill Lynch was lead manager in three of WPPSS's last five bond sales for Projects 4 and 5 and co-lead manager, along with Bache and Salomon Brothers Inc., in all five. Merrill Lynch's fixed-income research department issued a critical report in July 1981 entitled Washington Public Power Supply System: At the Crossroads (Sitzer and Karvelis 1981). The report discussed portfolio saturation; the likelihood that Plants 4 and 5 would be terminated; the serious difficulties involved in financing such a termination; the improbability of a state or federal bailout of the projects; new, much lower regional power-use growth forecasts; and the increasingly inhospitable political climate in Washington State. But the firm's sales staff aggressively marketed the bonds nonetheless. Reportedly the authors of the Crossroads report were told not to speak to the press and we are informed that they left Merrill Lynch shortly after the bond sale. Unit investment trusts such as the Municipal Investment Trust Fund, sponsored by Merrill Lynch, Dean Witter, Shearson, and Bache, bought and held increasingly heavy amounts of bonds through the early 1980s, thereby supporting the market for the bonds long after the denial of market access should have occurred,

and accordingly denying individual investors the danger signal that an institutional dumping of WPPSS securities would have provided.

Please advise the Subcommittee whether any civil or criminal cases have been or will be filed as a result of your investigation. Identify any and all targets or their representatives who have been shown your draft report or advised of your enforcement intentions and provide us with copies of any and all Wells submissions received by and summaries of any oral presentations made to the Commission on their behalf. Advise what legislative or administrative changes the Commission would recommend to clarify or strengthen the legal responsibility of investment and rating firms for adequate disclosure and financial advice.

We appreciate your cooperation and prompt response to our request. We are desirous of seeing to it that the Commission has the necessary tools and that the appropriate regulations are in place so that the WPPSS situation will not be repeated.

Sincerely,

/s/ John D. Dingell
JOHN D. DINGELL
Chairman
Subcommittee on
Oversight and Investigations

Enclosures

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent

U.S. House of Representatives
SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS OF THE
COMMITTEE ON ENERGY AND COMMERCE
Washington, D.C. 20515

October 19, 1984

Honorable John S. R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

Pursuant to the Rules of the House of Representatives and our continuing oversight of the nation's securities markets, the Subcommittee requests updated information on the status of the Commission's investigation in the matter of transactions in Washington Public Power Supply System (WPPSS) bonds.

On November 29, 1983, Daniel L. Goelzer, General Counsel of the Commission, in remarks before the Subcommittee on Public Authority of the Assembly of the State of New York, indicated that the Commission was investigating whether there had been violations of the federal securities laws in connection with transactions in WPPSS bonds. On January 11, 1984, the Commission announced the issuance of a Formal Order of Investigation in the Matter of WPPSS, File No. HO-1556 (49 FR 2035, January 17, 1984). Eighteen subpoenas reportedly were issued to several WPPSS officials and six major New York underwriters but, to our knowledge, only one case has been filed and that against a small brokerage firm named Multi-Vest. See "New York Broker Charged by SEC in WPPSS Case," *The Wall Street Journal*, February 22, 1984.

Please advise the Subcommittee whether any other cases have been or will be filed. For example, municipal bond analysts at Merrill Lynch, Pierce, Fenner and Smith Inc. issued a report in February 1979 warning that the supply system might face financial difficulty, with the possibility that the plants would not be completed, and that its bonds appeared to have been overrated by Moody's and Standard & Poor's. A strongly critical report was also issued on July 24, 1981. Nevertheless, Merrill Lynch underwriters and brokers ignored these reports and led in selling WPPSS bonds. Why have charges not been filed against the major Wall Street firms who sold the bulk of WPPSS bonds to the unsuspecting public?

Aside from the possible dissemination of false and misleading information by the Supply System and others, there appears to have been some fairly serious conflicts of interest. One was the profitability of the bonds. Estimates indicate that the investment houses and their brokers earned fees on the WPPSS bonds of 2 to 3 percent of the $2.25 billion total, or about $45 million to $67 million. In addition, some firms held the bonds in unit trusts or portfolios of bonds. An August 14, 1983 *New York Times* article reported that Merrill Lynch, among others, had more than $200 million of bonds from Projects 4 and 5 in its unit trusts. A drop in their price would have brought down the value of the trusts. Advise what leigslative or administrative changes the Commission would recommend to strengthen regulation in this area. Were these conflicts disclosed and, if so, where and to whom?

We appreciate your cooperation and prompt responses to our request.

Sincerely

/s/ John D. Dingell
JOHN D. DINGELL
Chairman
Subcommittee on
Oversight and Investigations

cc: Honorable Timothy E. Wirth
Honorable James T. Broyhill